



USAID Afghanistan Economic Governance Program

Volume 1 Completion Report

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**We appreciate the guidance and support
from our Afghanistan counterparts and
client, USAID.**

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**USAID
AFGHANISTAN
ECONOMIC GOVERNANCE PROGRAM**

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President Karzai, former US Ambassador Khalilzad and Tajikistan's President at the Sher Khan Bandar border post opening ceremony.

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Executive Summary

- Fiscal Technical Sector
- Financial Technical Sector
- Legal and Regulatory Technical Sector
- Trade Policy Technical Sector

Afghanistan is a *transitional economy* in almost all respects. For the past two decades, the nation has been plagued by regular internal transgression, the Soviet invasion as well as radical Taliban rule. As a result, both political and economic instability became the norm, rendering government agencies inoperable and leading to an immensely challenging reform landscape. In line with the *Recovery and Reconstruction Strategy for Afghanistan* as well as the nation's *National Development Framework*, the USAID Afghanistan Economic Governance (AEG) Program:

- Fostered sustainable economic growth,
- Implemented priority policy as well as institutional reform,
- Promoted sound economic management,
- Applied international best practices and
- Built human resource capacity.

USAID's AEG Program was a three-year initiative, beginning in November 2002 and concluding its operations in December 2005. Being the primary economic reform medium within the USAID development portfolio for Afghanistan, the program administered reform along four discrete technical sectors – *Fiscal, Financial, Legal and Regulatory* as well as *Trade Policy* – and employed more than seventy international advisors and more than four hundred Afghan staff, at its height.

Upon entering the country, initial assessments were performed to gauge reform needs and establish a comprehensive program plan, which would guide all reform tasks for the duration of the program. In doing so, numerous projects under the aforementioned technical sectors were outlined and implemented. Being wide in both depth and scope, team leaders were assigned to each technical sector and an overarching *Program Management Office* was established to monitor and ensure performance.

In looking at the *Fiscal Sector*, a large degree of technical assistance was applied to the *Customs Reform Project*, which saw considerable progress with the installation of standard operating procedures, in compliance with international standards, as well as a two-fold increase in customs revenue. In fact, for the duration of the program, customs proceeds accounted for more than half of the country's total domestic revenue. For transitional economies, raising and sustaining revenue is vital for the reduction and eventual elimination of donor aid. Furthermore, *Fiscal Sector* reform focused on enhancing Ministry of Finance core internal operations, such as tax policy and administration, budget operations and planning as well as regional office integration and management.

Providing a snapshot, with greater detail in later sections, significant strides have been made in the area of *Tax Reform* and included the design and implementation of two new revenue generating mediums: the *Business Receipts Tax* and the *Rental Services Tax*. At the same time, *Budget Reform* saw the complete analysis and restructuring of the budget preparation and analysis functions, leading to the timely preparation of operating budgets throughout the program's three years.

Looking at the *Financial Sector*, significant progress was made in the restructuring and strengthening of central bank operations, along with the installation of new mechanisms for enhanced operability, consistent with international standards and best practices. At the same time, *Financial Sector* reform focused on the country's nascent commercial banking sector, which is and will continue to be a conduit for private sector growth and development, the third pillar in the country's *National Development Framework*. In doing so, reform focused on establishing a central bank capable of managing the implementation of regulatory and technical infrastructures, required for the development of a competitive financial system.

Due to macro-economic reform measures, a *Macro-economic Policy Department* was established within *Da Afghanistan Bank* – the country's central bank, also referred to as DAB. It is now capable of successfully measuring the monetary impact of banking systems on economic growth and estimating money demand and prices, critical factors in economic management. In addition, the compilation and production of monetary statistics is now a routine function for the department. Furthermore, the country's first short-term financial instrument was designed and implemented, thereby providing a mechanism for defining benchmark rates of interest and pricing assets or liabilities.

In addition, the AEG Program successfully installed reliable payment distribution, transaction processing as well as communication systems for DAB and select regional branches. By the end of the program, and as graphically depicted in later sections, the *International Funds Transfer System* – SWIFT – processed nearly 11,000 transactions for almost \$5.3 Billion; the *Afghanistan Funds Transfer System* processed more than 6,600 transactions, which totaled Afn 60.1 Billion; and the *Domestic Inter-bank Clearing System* handled just under 2,400 transactions for almost Afn 9 Billion.

Similarly, the commercial banking sector saw considerable progress. A new DAB branch was established in Bagram, heavily used by the U.S. Military and providing the central bank with a medium for distributing Afghan currency. Moreover, nine financial institutions were granted licenses, while three others were successfully re-licensed. Progress such as this has given the commercial banking sector an impetus for change.

In sequence, the third area of reform included the *Legal and Regulatory Sector*. It was tasked with repairing the foundations of Afghanistan's commercial legal framework, and in the process, securing the backbone of a stronger legal system for the future. Fully detailed in later sections, *sixteen* different legal areas were addressed in conjunction with the Ministry of Justice and its legislative branch, the *Taqnin*. Furthermore, a wide ranging *Property Rights Project* was carried out and focused on surveying deed registry books in seventeen different regions.

The *regulatory* component of this mandate was met with the creation of an independent regulatory oversight system, namely the *Telecom Regulatory Board*, which was housed within the *Ministry of Communications* on an interim basis. In addition, all telecommunications services under the *Ministry of Communications* were successfully transferred, through a process defined as *corporatization*. It undertook and completed the transfer of all internal telecom operations to a corporation, namely Afghan Telecom, which was created and later *privatized*.

Finally, the *Trade Policy Sector* assessed the structure and operations of the Ministry of Commerce and evaluated Afghanistan's greater role within a regional framework. Policy papers were developed, defining the Ministry's mission statement as well as short, medium and long-term goals. In addition, methods for both regional and global integration were studied carefully, in order to establish a sound perspective on trade initiatives and the benefits of potential membership. For instance, the Ministry was encouraged to consider avenues like the *South Asian Free Trade Area*, a regional integration vehicle sponsored by the *South Asian Association for Regional Cooperation*, and accession into the *World Trade Organization*.

In addition, a large segment of the trade policy reform initiative focused on the elimination of *administrative barriers to trade*. A central working group was therefore established to assess any barriers, provide remedial courses of action and build capacity within the group itself for future application. By following this approach, technical assistance was applied as a means, aimed at achieving the end of full *sustainability*. Moreover, immense progress was made in the reform of *Business Licensing* procedures. Former processes were severely antiquated, and as a result, a new system was designed and subsequently implemented. It successfully reduced a previously cumbersome process to forty-eight hours of processing time, a three-step application and only 6 signatures.

The USAID *Afghanistan Economic Governance Program* has certainly been challenging; however, it has been a pleasure for BearingPoint to assist USAID in its administration of technical assistance for such a critical piece of US foreign policy.

In reading this *Program Completion Report*, please note that it is the culmination of both weekly and monthly monitoring and encompasses the tasks of the prime contractor as well as its subcontractors. At the onset of the program, the contract value was more than \$30 Million, and by the end of the program, it was amended and consequently increased three-fold to meet a much larger scope of work. Finally, this report was written to accurately document both the depth and breadth of this large scope of work, providing the reader with a valuable snapshot of the *before and after*, a large degree of supporting data, lessons learned – embedded within each of the *technical assistance* sections – and guidance for future reform as well as photos.

Fiscal Technical Sector

- Afghanistan's Ministry of Finance
- Headquarters and Provincial Locations

Customs Policy and Administration

The Customs Reform Project included all of Afghanistan, with Kabul City and select regions as the major focal points. In looking at the project's schema, reform was directed at the fundamentals of a properly functioning customs system, in an effort to increase total customs revenue and install standard operating procedures.

Customs revenue totaled AFN 4.46 Billion at the conclusion of Afghan solar year 1382. This has rapidly increased to a projected AFN 9.2 Billion for year 1384 and should represent half of Afghanistan's total domestic fiscal revenue by the end of the same solar year.

To furnish an increase in revenue, technical assistance was offered in a number of strategic reform areas, culminating in a comprehensive reform plan and leveraging international best practices. A snapshot of the reform is included here:

- Drafting of a new Customs Law
- Implementation of a new Tariff System
- Installation of an Exemption Policy
- Implementation of a Brokers Program
- Installation of the Simplified Customs Clearance System
- Enhancement of Valuation Procedures
- Introduction of "pre-fab" Customs Houses at 5 border posts
- Accession into the World Customs Organization
- Introduction of Mobile Customs Teams
- Enhancements in Data Collection and Analysis - Eurotrace System
- Training in HS Tariff Classification & Customs Valuation for 500 Afghans.

At the same time, the erection of border posts or crossroads in strategic areas was a priority. This task was met with considerable progress, and seventeen border posts or crossroads are now in operation. They include the following:

| | | | |
|--------------|------------------|----------------|-------------|
| Torkham | Sher Khan Bandar | Mazar-e-Sharif | Aquina |
| Spin Boldak | Dgazi | Kabul Terminal | Gardez |
| Eslam Q'Aleh | Zaranj | Ghulum Khan | Ankoi |
| Heiratan | Torghundi | Kabul Airport | Konduz City |
| Khost | | | |

The erection of reliable Customs Houses at strategic Afghan locations was a critical piece of reform because these buildings offer local Customs Officers with the infrastructure and equipment needed to effect proper Customs control and enforcement. In addition, the houses were connected to the broader Customs Information Technology network, used to link regional locations and headquarter staff.



Here we see before and after photos of the Ghulum-Khan site, which is located in the Khost Province. The inherent benefits of this building are noticeable, if one considers the rough terrain in this area of Afghanistan. Aside from their aesthetic qualities, these pre-fabricated buildings are both functional and able to house numerous Customs personnel. Here, forty-five staff members can be assigned on a full-time basis.



Upon project commencement, a high-level assessment of Customs Operations was conducted to determine system deficiencies or problems. From this analysis, a number of Strategic Reform Areas were identified, and a synopsis of these original problems or needs (with accompanying solutions) has been provided in the following pages:

➤ *Exchange Rate*

Multiple exchange rates were being used within Customs Operations at the start of the Customs Reform Project. This practice provided uncertainty among traders and Customs Officers, created a heavy administrative cost and developed an incentive for importers to clear their goods at locations with lower rates.

In response to this, Customs Operations adopted the international standard: the official market rate published by a nation's Central Bank. To offset the inflation of import values, as a result of this change, a sharp reduction in the structure of import duties was installed (from a maximum of 150% to 25%), and the total number of tariff bands was reduced (from 26 to 4).

➤ *Import Related Exemptions*

A monitoring system for exemptions in Afghanistan did not exist at the onset of the Customs Reform Project. As a result, it was unclear a) who benefited from exemptions, b) what products were exempt, c) what legislation supported exemptions, d) how much revenue was foregone and e) where destinations for exempted goods were.

In response, a simple and streamlined administrative and documentary system was implemented, identifying the applicant, his or her products, any legal documentation as well as the final destination of goods.

➤ *Tariff Policy*

Afghanistan's Tariff Policy was plagued by an excessive number of ad-valorem duties, specific duties and specified values. Many of these were extremely low and failed to represent actual transaction values. In addition, the bargaining capacity of importers was high, and a considerable quantity of goods was being re-classified into lower rate brackets, a sign of bribe payments. Finally, goods with a "zero" rate were often unregistered, leading to a distorted representation of the economy's true imports.

In response, the Customs duty tariff structure was simplified, reducing the prior twenty-six rates and replacing them with a four-tier system. Noted in the previous section, the 0-150% system became a 0, 5, 10 or 25% mechanism, establishing a more appropriate sequence of rates.

➤ *Tariff Codification*

Afghanistan's Tariff System used a domestically oriented coding system, which included both vocabulary and the categorization of products. Conversely, Afghanistan's economic activity is largely international, calling for the adoption of an internationally oriented system, which facilitates trade and attracts business partners (accustomed to internationally based systems).

In response, a coding system was designed to more closely resemble international best practices, namely the globally recognized Harmonized System (HS). This resulted in the initial addition of four HS digits to the Afghan Tariff System. The new coding system became more "user-friendly" and included national sub-headings for reasons of import substitution, protection and statistical analysis. Finally, the codification system was later raised to eight digits.

➤ *Customs Declaration*

Afghanistan was using its own Customs declaration forms, unlike a majority of the international community, which uses a standardized system. The end result was a lack of information, leading to deficiencies in the actual forms and hampering Post Clearance Audits.

In response, international best practices have been adopted by modifying the Single Administrative Document (SAD) and installing the Afghan Customs Clearance Document (ACCD). The system remains manual; however, automation will take effect after the Asycuda System is installed.

➤ *Transit of Goods*

The international transit of goods has suffered from the payment of import duties, largely in Kabul City and Jalalabad. At the same time, information about the collection of these duties is meager at best, and the expected rehabilitation of the artery linking both Pakistan and Afghanistan has called for the design of new transit documents and procedures.

In response to superficial (and sometimes non-existent) legislation, reform took the shape of increased specificity within the Customs Code (described in the "Customs Legislation" section). Nonetheless, actual implementation of these legal guidelines remains a critical piece of reform, which will install standard operating procedures for the transit of goods and define official routes as well as time limits.

➤ *Valuation*

Initially, valuation was not the responsibility of the MoF Customs Department. It was under a separate jurisdiction and largely dysfunctional, with arbitrary values and no adherence to international standards.

In response, valuation was adopted as a direct responsibility of the Customs Department, with Customs Officers subsequently being trained in the rules and regulations of valuation (established by the World Trade Organization). Afghanistan is now prospering from a reliable and predictable system, reducing time delays in the process.

➤ *Customs Legislation*

Customs legislation was largely antiquated and did not include modern regulations. In light of this, full Customs legislative reform was initiated and included a new Customs Code, Customs Decree and Customs Directives. Reform was supported by standard operating procedures and recognized the rules of international treaties and conventions (notably the World Customs Organization).

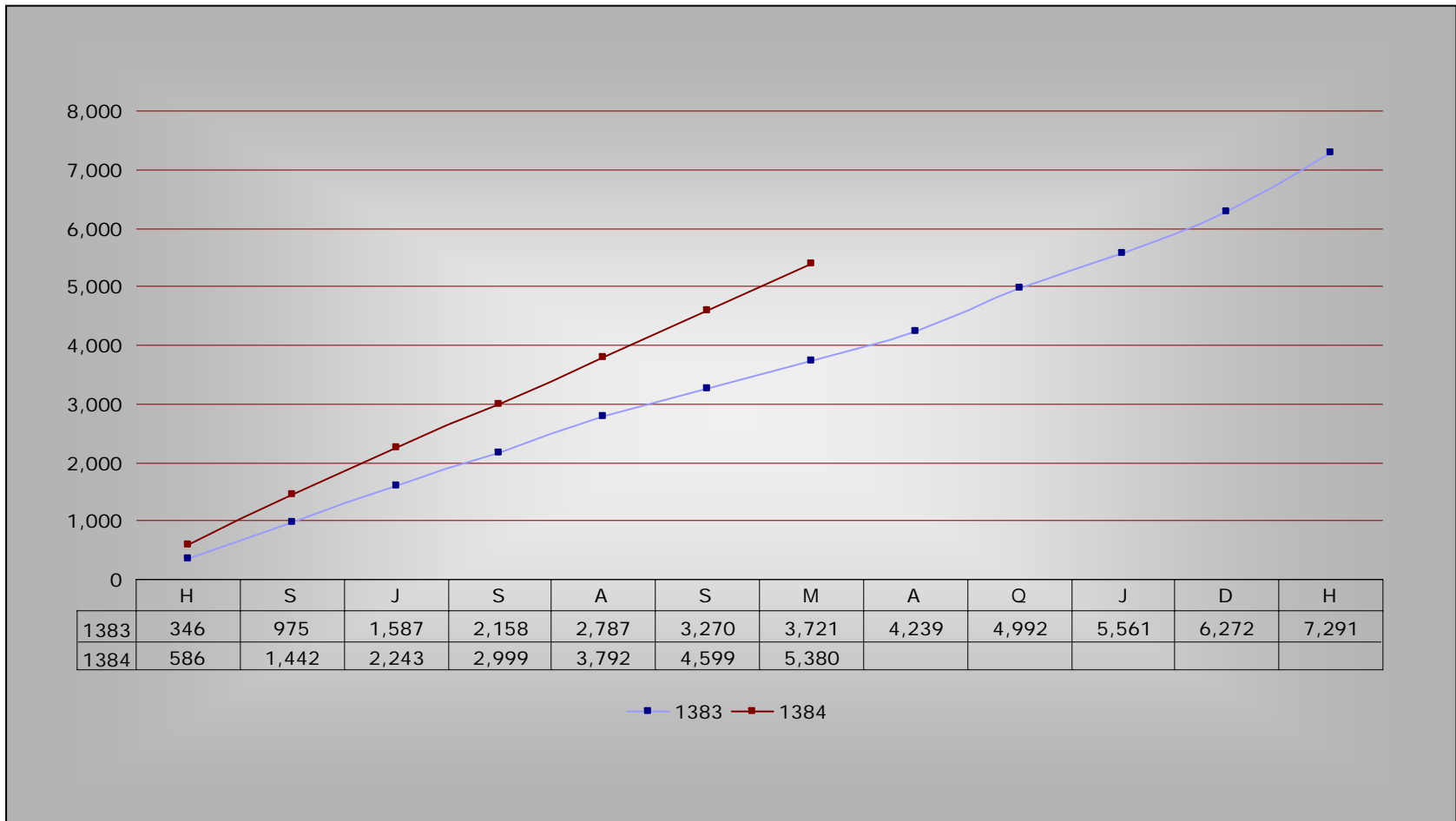
New Customs legislation has provided traders with a simple, modern and predictable code. In addition, the Customs Department now has the legal means to increase and protect revenue, by enforcing the legislation itself.

➤ *Customs Revenue Generation*

As a result of these reforms, the collection of Customs Revenue in Afghanistan has increased considerably; offering increased funding for the nation's Operating Budget and lessening its reliance on donor aid. Here is a snapshot of Customs Revenue collected since the beginning of the Customs Reform Project:

- *Total Customs Revenue – 1382: Afn 4,462 Million*
- *Total Customs Revenue – 1383: Afn 7,291 Million
{+ 63% from 1382}*
- *Total Customs Revenue – 1384 {initial seven months}: Afn 5,380 Million
{+ 45% from the same period in 1383}*
- *Total Customs Revenue – 1384 Projection {solar year end}: Afn 9,200 Million
{+ 106% from 1382}.*

➤ **1383 and 1384 – Total Customs Proceeds – *Afn* Million**



➤ *Customs Broker Program*

From the beginning, Customs regulations were hindered by a lack of reputable Customs agents. In order to avoid the collection of Customs duties or taxes, these agents would regularly provide their services at a reduced fee, which resulted in a huge under-valuation of invoices and loss of revenue.

As a result, a Customs Broker Program was recommended, aimed at staffing Clearance Agents and promoting uniformity. The program would improve the accuracy of Customs declarations and reduce malpractice by providing a Customs bond, enforceable only by the Ministry of Finance.

A Customs Broker Program was developed through the Customs Reform Project, and Dr. Ashraf Ghani, Afghanistan's former Finance Minister, presided over the nation's first Customs Broker licensing ceremony, as shown in the picture below.

Professional, licensed Customs Brokers are critical links between the private sector and Customs authorities. As such, they are essential for improving the integrity of the entire Customs development process in Afghanistan, while ensuring that revenue for the future reconstruction of the country is collected and transferred to the state. Unfortunately, a lack of governmental support nullified the program's sustainability, and it was subsequently discontinued.



➤ *World Customs Organization*

Afghanistan officially took its place as the newest member of the World Customs Organization. WCO membership was identified as a key component of USAID's Customs Reform Project. In addition to providing international Customs models and procedures, the organization sponsors both on-site and out-of-country capacity building and technical assistance programs, elements that will enhance progress and foster international cooperation.



Secretary General Danet, Chekeba Hachemi, Afghan Director of Customs Kammawie and Second Secretary Monar discussing Afghanistan's accession document.

World Customs Organization membership is a great step forward in Afghanistan's goal to become fully integrated with the international community. The WCO annual Council Session provided the opportunity for 165 Customs Heads to meet and discuss international Customs cooperation, and at last year's session, Afghanistan was welcomed as the organization's newest member. In addition, the General Director of Customs, Mr. Bismellah Kammawie, outlined the state of Afghanistan's Customs Reform Program and expressed gratitude to all nations providing assistance to the Islamic republic.



Tax Policy and Administration

Both indirect and direct taxes are major sources of revenue for government entities throughout the world. A properly functioning tax regime, with adequate mediums for both collection and enforcement, helps in the funding of a nation's recurring budgets and promotes self-reliance. For transitional economies, the need for a well-functioning taxation system becomes even more pressing.

Upon entering Afghanistan, it was clear that major reform would be needed to bring the Islamic republic in line with its neighbors and with international standards in general. Undoubtedly a transitional and war ravaged economy, the major goal was to design a fundamentally sound tax policy framework, able to sustain both the short-term need for revenue and the long-term need for a market-oriented taxation system.

Due to these guidelines, a series of high-level assessments were initially made within the Ministry of Finance to identify a baseline for reform and gauge the institution's genuine ability to introduce and manage a proper taxation system. Based on these results, the following road map was produced, as a guide to meet the short and long-term needs of a taxation system in Afghanistan:

| Task Name | Status |
|--|--------|
| Plan and implement a <i>Rental Services Tax</i> | ✓ |
| Register both landlords and tenants – primarily <i>Kabul City</i> | ✓ |
| Develop and implement a <i>taxpayer service and education program</i> | ✓ |
| Develop and implement a <i>Ministerial Instructions Program</i> | ✓ |
| Develop and implement <i>payment, filing and collection procedures</i> | ✓ |
| Develop and implement an <i>Enforcement Program</i> | ✓ |

| Task Name | Status |
|--|--------|
| Develop and implement a <i>Business Receipts Tax</i> | ✓ |
| Register <i>service payers</i> in <i>Kabul City</i> | ✓ |
| Develop and implement <i>payment, filing and collection procedures</i> | ✓ |
| Develop and implement a <i>taxpayer service and education program</i> | ✓ |
| Develop and implement an <i>Enforcement Program</i> | ✓ |
| Hold <i>taxpayer service training programs</i> in other cities | ✓ |
| Develop and implement a <i>fixed tax schedule</i> on money changers | ✓ |
| Register money changers in <i>Kabul City</i> | ✓ |
| Develop and implement <i>payment, filing and collection procedures</i> | ✓ |
| Develop and implement an <i>Enforcement Program</i> | ✓ |
| Enhance the <i>Taxpayer Identification Numbering – TIN – System</i> | ✓ |
| Establish <i>information campaign</i> on new TIN requirements | ✓ |
| Reform pre-existing TIN <i>policies and procedures</i> | ✓ |
| Boost TIN <i>membership</i> in <i>Kabul City</i> | ✓ |
| Roll the TIN system out to selected regions | ✓ |

| Task Name | Status |
|--|--------|
| Develop a <i>Wage Withholding Tax</i> | ✓ |
| Develop <i>ministerial instructions</i> | ✓ |
| Develop a <i>taxpayer service and education program</i> | ✓ |
| Develop <i>payment, filing and collection procedures</i> | ✓ |
| Develop <i>training programs</i> for Afghan staff | ✓ |
| Establish <i>Compliance Program</i> and enhance <i>confidence in tax affairs</i> | ✓ |
| Establish linkages with <i>industry</i> and NGO forums | ✓ |
| Promote <i>business taxation advisory services</i> | ✓ |
| Conduct <i>national liaison meetings</i> for the <i>Business Receipts Tax</i> | ✓ |
| Establish <i>Taxation Education Program</i> | ✓ |
| Establish <i>taxpayer publications</i> on new <i>taxation measures</i> | ✓ |
| Develop <i>priority schedule</i> for <i>publications</i> | ✓ |
| Design and produce <i>new publications</i> | ✓ |

| Task Name | Status |
|---|--------|
| Establish <i>community consultation programs</i> on new tax measures | ✓ |
| Establish <i>pilot taxpayer education program</i> for Kabul City | ✓ |
| Develop a <i>Charter of Taxpayer Rights</i> | ✓ |
| Establish <i>Enforcement and Compliance</i> policies | ✓ |
| Establish <i>risk management strategies</i> | ✓ |
| Establish processes for the <i>review of taxation assessments</i> | ✓ |
| Establish an <i>Appeals Office</i> | ✓ |
| Develop a <i>legislative base</i> for taxation policy and administration | ✓ |
| Amend tax laws to facilitate both <i>short</i> and <i>medium-term functions</i> | ✓ |
| <i>Business Receipts Tax</i> | ✓ |
| <i>Rental Services Tax</i> | ✓ |
| <i>Taxpayer Identification Numbering System</i> | ✓ |
| <i>Collection Enforcement</i> | ✓ |
| Establish <i>Taxation Ruling Program</i> | ✓ |
| Boost <i>organizational infrastructures</i> to facilitate taxation | ✓ |
| Establish a <i>Large Taxpayers Office</i> | ✓ |
| Re-align <i>reporting relationship</i> with provincial offices | ✓ |

| Task Name | Status |
|--|--------|
| Establish HQ <i>organizational structure</i> | ✓ |
| Establish new <i>regional management structure</i> | ✓ |
| Boost <i>administrative capabilities and capacity</i> | ✓ |
| Establish <i>standard operating procedures</i> | ✓ |
| Establish a <i>Code of Conduct</i> | ✓ |
| Establish a <i>Human Resource Function</i> | ✓ |
| Conduct and promote <i>staff training</i> | ✓ |
| Establish <i>physical infrastructure</i> to aid <i>taxation measures</i> | ✓ |
| Building <i>refurbishment</i> | ✓ |
| <i>Information Technology</i> | ✓ |
| Design a <i>medium-term computer platform</i> | ✓ |

➤ *Taxpayer Identification Numbering System*

A new Taxpayer Identification Numbering System was implemented in September 2003. Once the system was fully installed in Kabul City, the new processes were spread to five provincial locations. Through the roll out of these new methodologies, personnel within the Ministry of Finance received on-the-job training, thereby enhancing Afghanistan's ability to effectively administer the new process.

At the same time, a partnership was initiated with both the Afghan Investment Support Agency and Ministry of Commerce to ensure collaboration with the Business Licensing process. In examining pages twenty-seven and twenty-eight, you will see that a significant amount of progress has been achieved with the TIN program. Nonetheless, the system must remain a priority, in order to reach nationwide status. This will call for investment, ministerial support as well as human resource training.

➤ *Rental Services Tax*

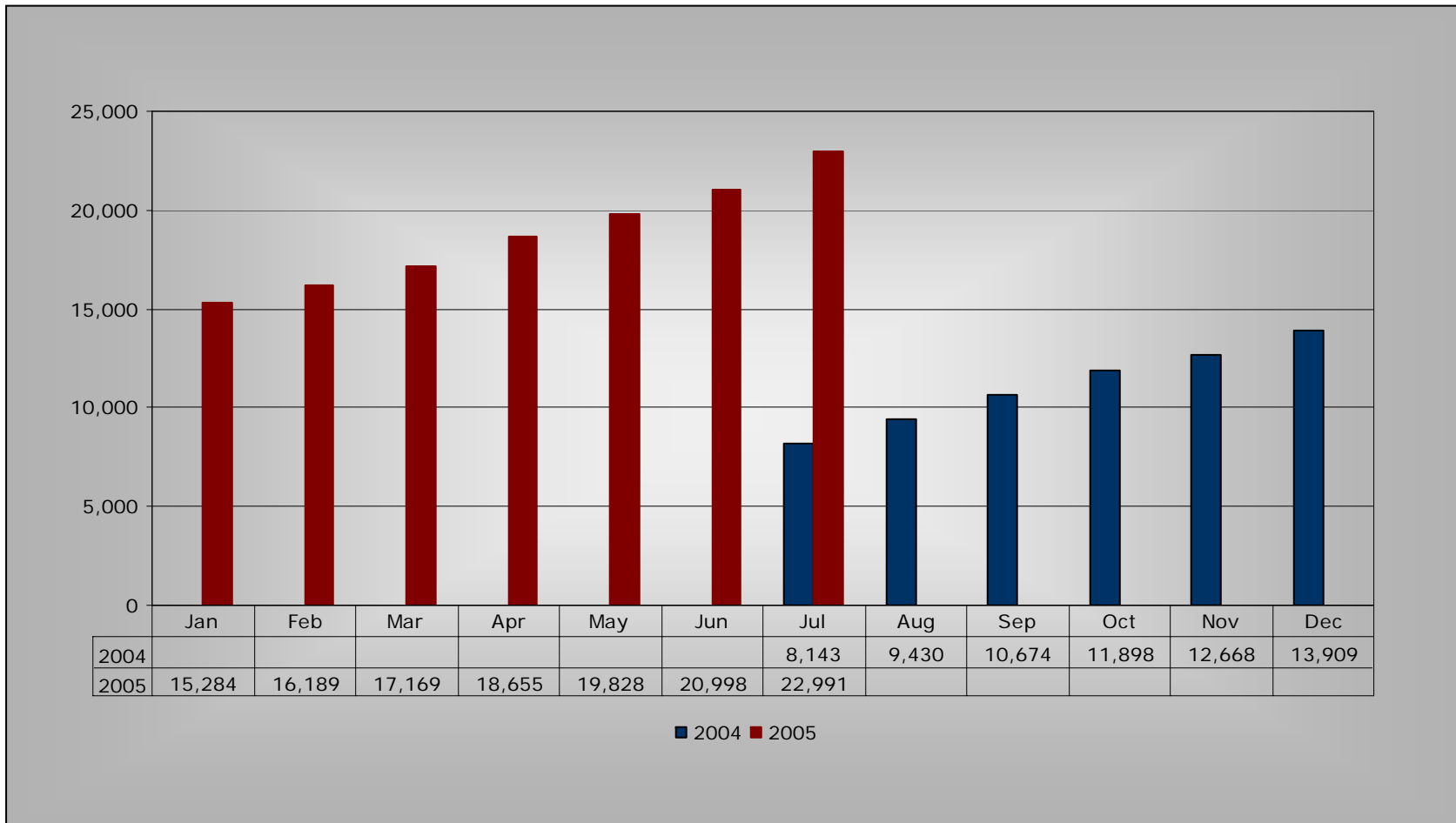
A Rental Services Tax was planned and subsequently installed in March 2004. In order to ensure the medium-term sustainability of the system, more than fifty staff members (MoF) were trained in the administration of this discrete tax medium. In addition, a media campaign was arranged to raise public awareness and promote membership. Finally, an Assessment Team was established to act as a remedial measure for non-compliant persons.

Like the TIN system, the Rental Services Tax has made tremendous gains. In just over two full years, more than 1,600 payments have been made, totaling just under Afn 191 Million. Again, these are positive results considering the short time frame and lack of initial Afghan taxation expertise. Being a transitional economy, Afghanistan must sustain all revenue growth, of which the Rental Services Tax will play both a critical and long-term role.

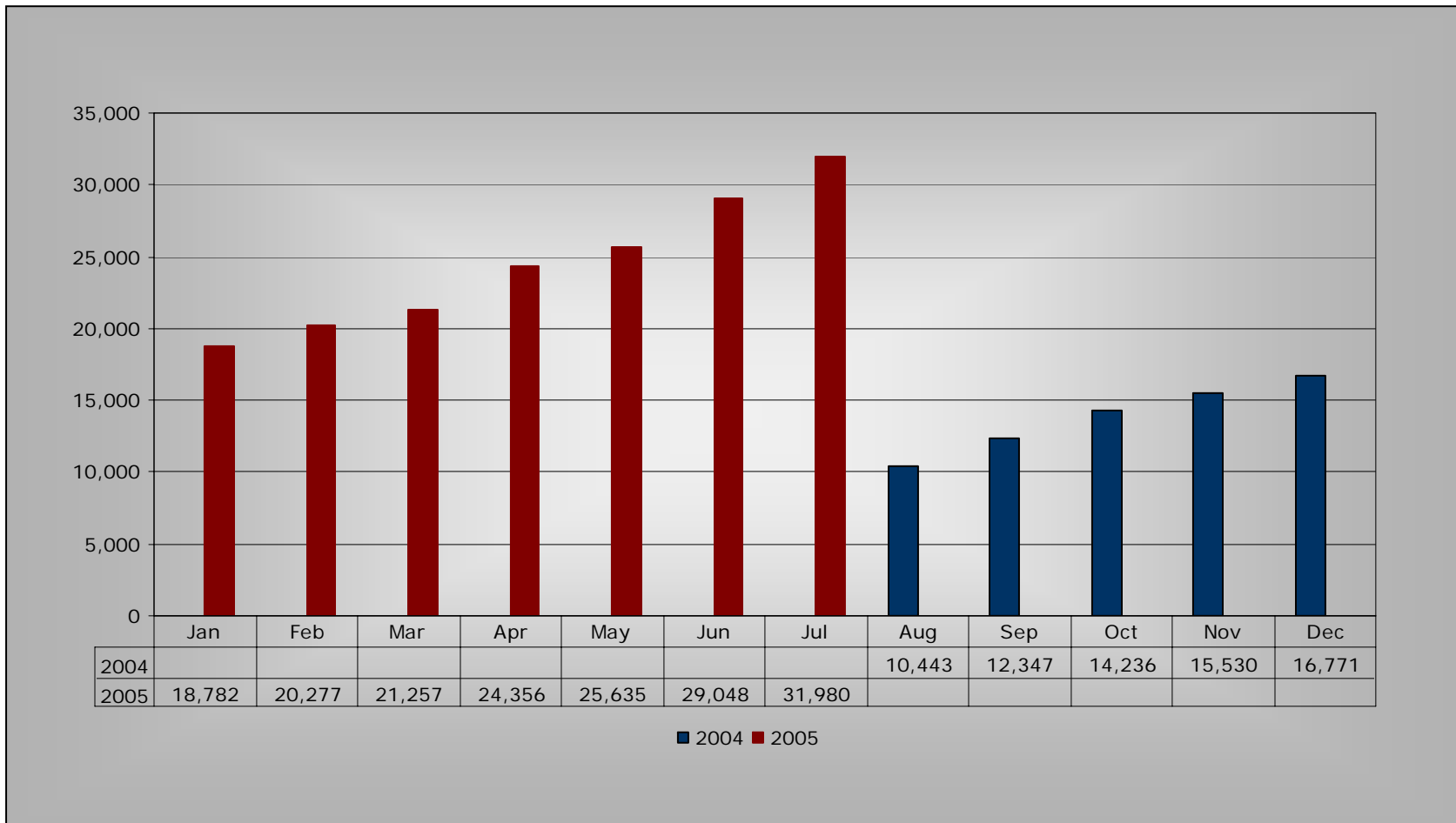
➤ *Business Receipts Tax*

While yielding less than the Rental Services Tax, the Business Receipts Tax was another milestone under the Tax Policy and Administration Project. It was implemented in July 2004, with on-the-job training for more than forty staff members within the Ministry of Finance. At the same time, and in similar fashion to the Rental Services Tax, a media campaign was arranged to raise public awareness, while establishing another Assessment Team to handle any non-compliant persons. In two years, just under 300 payments were collected under the new system, totaling almost Afn 6.6 Million.

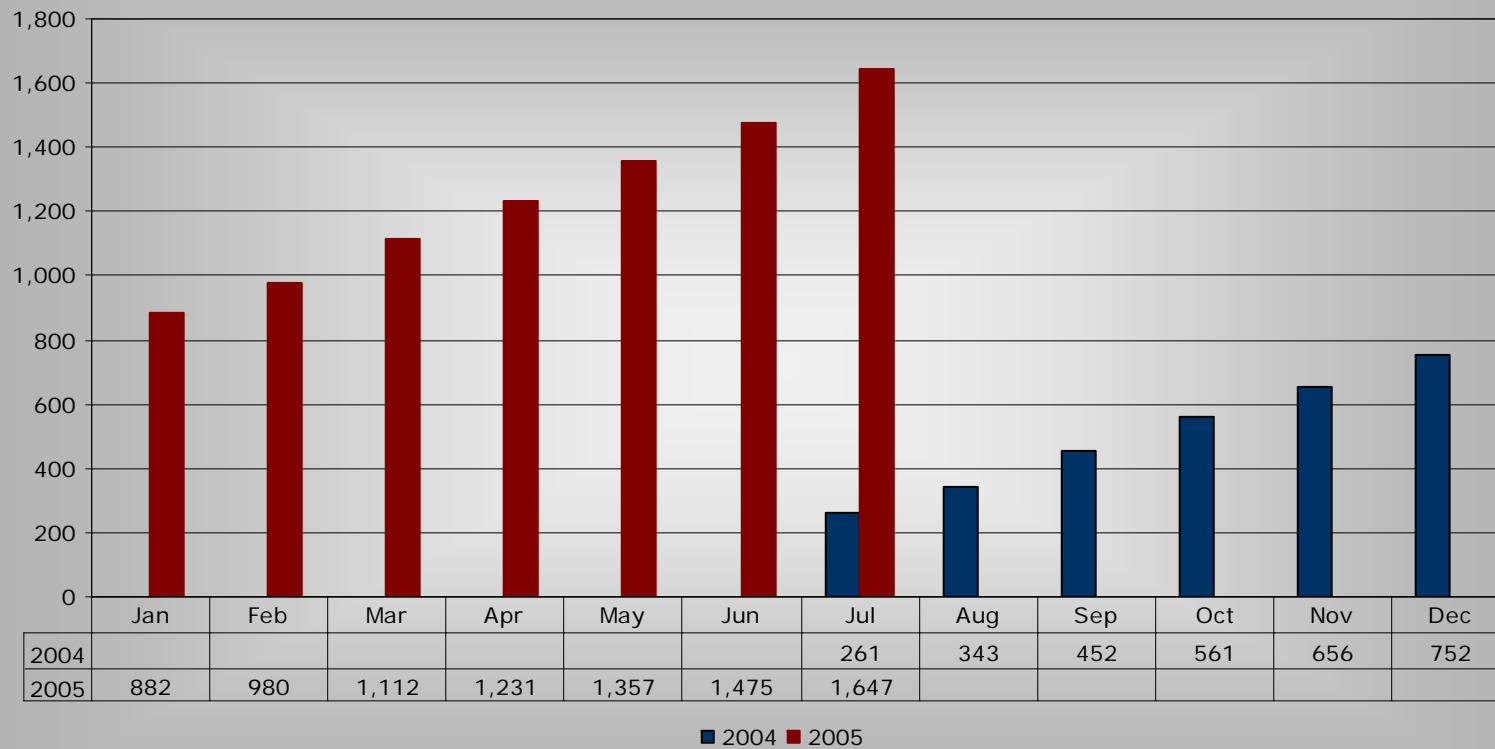
➤ 2004 and 2005 – Taxpayer ID Numbers Issued – *Kabul City*



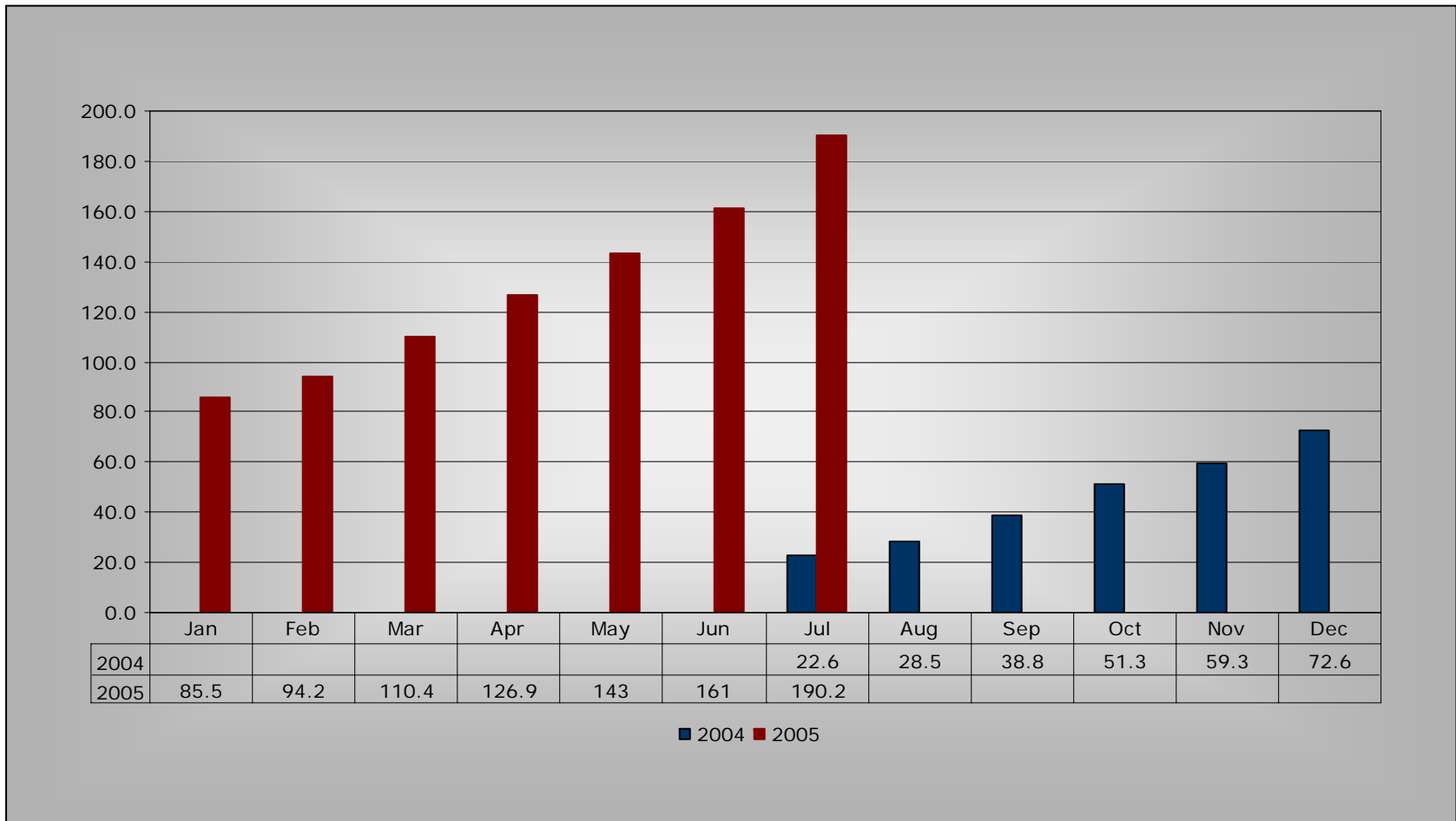
➤ 2004 and 2005 – Taxpayer ID Numbers Issued – *Afghanistan*



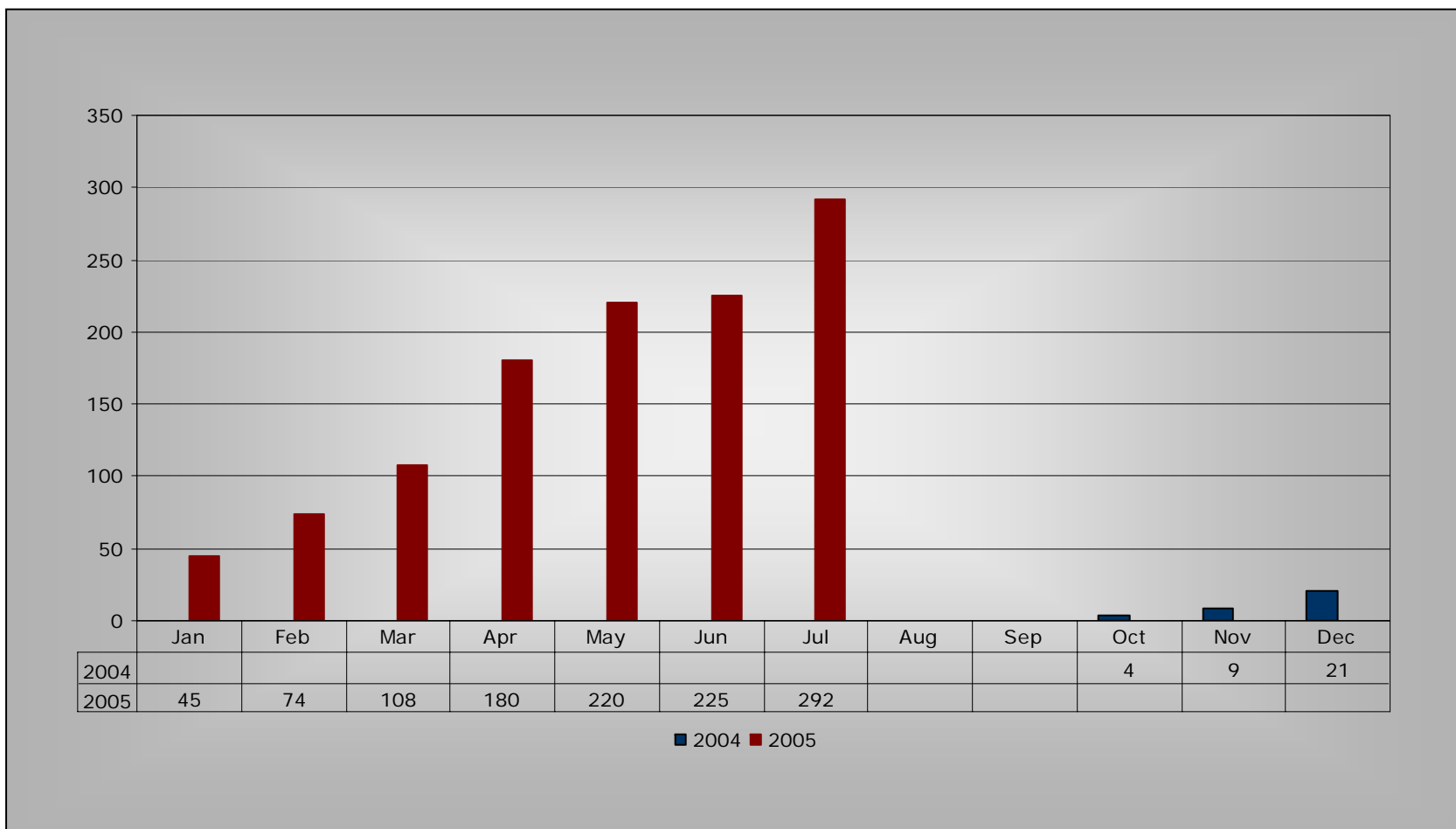
➤ 2004 and 2005 – Rental Services Tax Payments



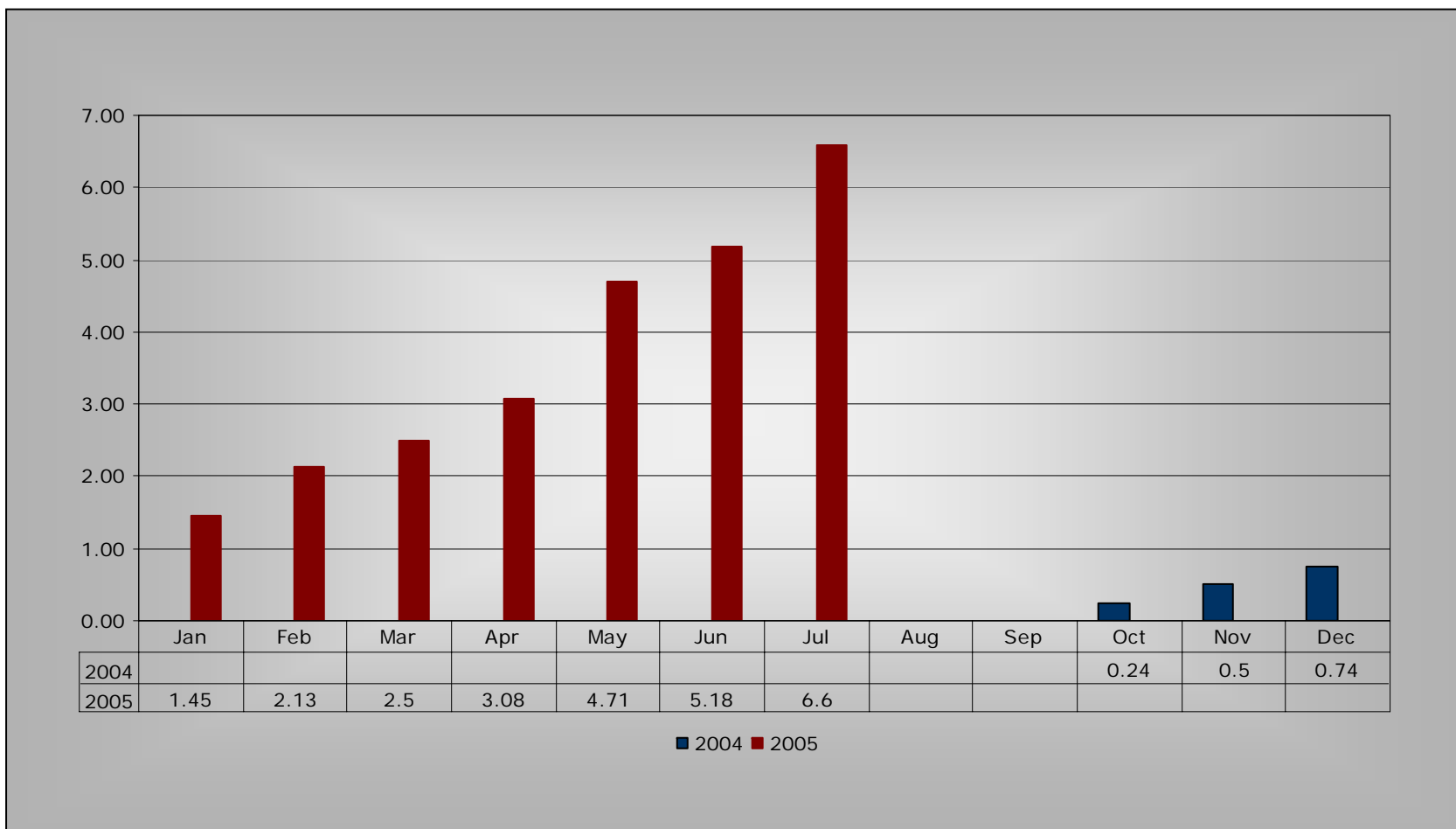
➤ 2004 and 2005 – Rental Services Tax Revenue – *Afn Millions*



➤ **2004 and 2005 – Business Receipts Tax Payments**



➤ **2004 and 2005 – Business Receipts Tax Revenue – Afn Millions**



➤ *Fiscal and Taxation Training*

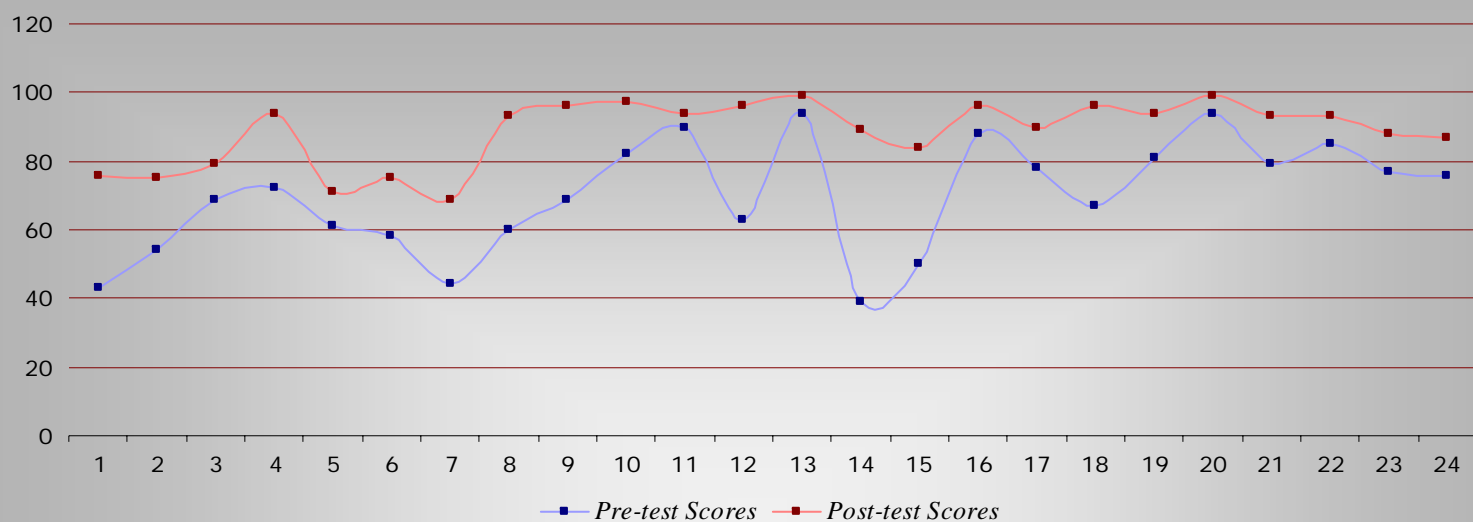
As noted in prior sections, transitional economies rely on revenue generation for both medium and long-term progress. A large degree of emphasis was therefore placed on capacity building for Ministry of Finance staff members, focusing on general and more sophisticated mediums for generating revenue and meeting international standards of collection and sustainability.

The following is a detailed summary of taxation training within the Ministry of Finance. As you will see, seminars and courses initially focused on fundamental topics, with gradual progression to more advanced subject matters. In addition, please note that the majority of formal training (on-the-job training was present from the beginning of the AEG Program) was administered in 2005, since the first two years of the Tax Policy and Administration Project focused on the implementation of new systems and functional areas inside the Ministry of Finance.

| -- | Course | Participants | Date |
|----|--|--------------|-------------------------------|
| 1 | Resource Persons Orientation | 13 | January 1, 2005 |
| 2 | Resource Persons Orientation | 13 | January 9, 2005 |
| 3 | Training on Formation of Legal Entities | 31 | January 16, 2005 |
| 4 | Selection of Trainers Workshop | 10 | January 17 - 23, 2005 |
| 5 | Cross training on RST and BRT (A) BRT Training | 10 | January 30 - February 1, 2005 |
| 6 | (B) RST Training | 21 | January 30 - February 1, 2005 |
| 7 | Training on Tax Treatment of Legal Entities | 24 | February 3, 2005 |
| 8 | Introduction to Taxation Training for LTO Employees: Group (A) | 16 | February 6 – 8, 2005 |
| 9 | Training on the Operation of State Owned Enterprises | 30 | February 9, 2005 |
| 10 | Introduction to Taxation Course for LTO Employees Group B | 16 | February 13 – 15, 2005 |

| | | | |
|----|--|----|--------------------------|
| 11 | IT Training for LTO Staff Groups A, B, C, D, E and F | 30 | February 13 – 27, 2005 |
| 12 | Training on Taxpayer Service: Group A | 17 | March 5 - 7, 2005 |
| 13 | Training on Taxpayer Service: Group B | 19 | March 12 - 14, 2005 |
| 14 | Training on Taxpayer Service: Group C | 16 | March 19 - 23, 2005 |
| 15 | An Overview of Taxation | 16 | April 3 – 5, 2005 |
| 16 | An Introduction to Income Tax | 16 | April 9 – 11, 2005 |
| 17 | Wage Withholding Taxes Resource Persons | 16 | April 12 - 14, 2005 |
| 18 | Tax Incentive | 8 | April 13– 14, 2005 |
| 19 | Wage Withholding Taxes Course Group A | 16 | April 16 - 18, 2005 |
| 20 | Wage Withholding Taxes Course Group B | 14 | April 19 – 23 |
| 21 | Tax Training for New Entrants | 22 | April 23 – July 22, 2005 |
| 22 | Wage Withholding Taxes Course Group C | 18 | April 24 - 26, 2005 |
| 23 | Deduction, Depreciation and Treatment of Losses Course for Resource Persons | 17 | May 2 – 4, 2005 |
| 24 | Introduction to Income Tax Course First group | 16 | May 18 – 21, 2005 |
| 25 | Introduction to Income tax Course Second group | 15 | May 24 – 26, 2005 |
| 26 | Business Expenses, Depreciation and Losses Course for LTO | 18 | May 28 – 30, 2005 |
| 27 | The Coverage of Income Tax Course | 18 | June 4 – 6, 2005 |
| 28 | Introduction to Income Tax Course Third Group | 16 | June 7 -9, 2005 |
| 29 | Calculating The Income Tax Liability Course | 17 | June 11 – 13, 2005 |

| | | | |
|-------------------------------------|--|-----|-------------------------|
| 30 | Business Expenses, Depreciation and Treatment of Losses Course: LTO and BRT as well as RST group A | 14 | June 21 – 23, 2005 |
| 31 | Business Expenses, Depreciation and Treatment of Losses Course: Revenue Presidency, LTO as well as BRT and RST Group B | 17 | June 25 - 27, 2005 |
| 32 | Coverage of Income Tax Course: Revenue Presidency and LTO | 15 | June 28-30, 2005 |
| 33 | BRT – VAT Course for Resource Persons | 18 | July 2-4, 2005 |
| 34 | BRT – VAT Course for LTO | 17 | July 5-7, 2005 |
| 35 | Coverage of Income Tax Course for BRT and RST groups | 27 | July 5-7, 2005 |
| 36 | Calculating Income Tax Liability Course for LTO | 17 | July 9-10, 2005 |
| 37 | Calculating Income Tax Liability Course for BRT and RST groups | 27 | July 11-12, 2005 |
| 38 | Fixed Tax Course for Resource Persons | 17 | July 13, 2005 |
| 39 | Fixed Tax Course for LTO | 15 | July 14, 2005 |
| 40 | Management Course for Directors | 15 | July 16-21, 2005 |
| 41 | Fixed Tax Course for BRT and RST groups | 27 | July 23, 2005 |
| 42 | Basic Account Training for Wage Withholding and LTO | 32 | July 24-30, 2005 |
| 43 | Basic Audit Training for Revenue Presidency, LTO and Kabul Mustofiat personnel | 33 | July 31-August 4, 2005 |
| 44 | Management Course for Revenue Presidency officials | 11 | July 31-August 6, 2005 |
| 45 | Computer Training for Wage Withholding Tax Group | 22 | July 31-August 10, 2005 |
| <i>Total Number of Participants</i> | | 833 | |

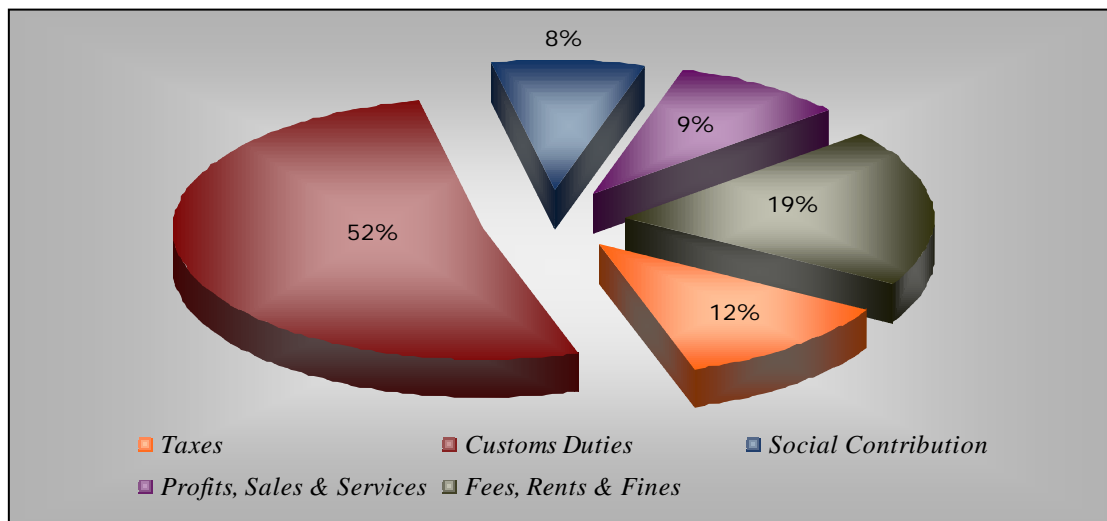


| | | | | | |
|---|--|----|--|----|------------------------------------|
| 1 | <i>Business Receipts Tax Training</i> | 9 | <i>Wage Withholding – Group B</i> | 17 | <i>BRT & VAT</i> |
| 2 | <i>Rental Services Tax Training</i> | 10 | <i>Wage Withholding – Group C</i> | 18 | <i>BRT & VAT 2</i> |
| 3 | <i>Introduction to Taxation – Group A</i> | 11 | <i>Deduction, Depreciation and Treatment of Losses</i> | 19 | <i>Coverage of Income Tax</i> |
| 4 | <i>Introduction to Taxation – Group B</i> | 12 | <i>Deduction, Depreciation and Treatment of Losses 2</i> | 20 | <i>Income Tax Liability</i> |
| 5 | <i>Taxpayer Service Training – Group A</i> | 13 | <i>Coverage of Income Tax</i> | 21 | <i>Income Tax Liability 2</i> |
| 6 | <i>Taxpayer Service Training – Group B</i> | 14 | <i>Deduction, Depreciation and Treatment of Losses 3</i> | 22 | <i>Fixed / Presumptive Taxes</i> |
| 7 | <i>Tax Incentives Training</i> | 15 | <i>Deduction, Depreciation and Treatment of Losses 4</i> | 23 | <i>Fixed / Presumptive Taxes 2</i> |
| 8 | <i>Wage Withholding – Group A</i> | 16 | <i>Coverage of Income Tax 2</i> | 24 | <i>Fixed Taxes</i> |

➤ *Guidance for Future Reform*

The short-term framework for a gainful taxation system in Afghanistan has been established within the Ministry of Finance. At the conclusion of the AEG Program, taxes accounted for approximately twelve percent of all Total Domestic Revenue. In certain respects, this can be seen as an indicator for medium-term success, with the idea of both sustaining and enhancing existing systems.

In looking at the following pie chart, one can begin to understand the impact of a well functioning taxation system for transitional economies. In the depiction below, from October 2005, taxes are the third largest contributor of domestic revenue. With proper attention from the GOA, especially the Ministry of Finance, this is a fiscal medium capable of increasing total domestic revenue and reducing the need for donor aid.



To sustain this progress, the GOA must continue to promote collection and enforcement, in conjunction with increased training and staff retention. As a result of low wages and a growing job market, many trained employees are choosing to leave the Ministry of Finance for higher paying wages. The success of a properly functioning taxation system is reliant on the ability to staff capable and trained employees. They are the key to short, medium as well as long-term progress and must be paid competitive wages to remain.

At the same time, capacity building and sustainability should aim at train-the-trainer methods, facilitating proper training when international assistance is reduced or eliminated completely. Taxation, along with its ability to generate revenue, is key in the promotion of self-reliance. A stable workforce is a prerequisite for self-reliance and the gradual move to non-transitional status.

At the conclusion of the AEG Program, the train-the-trainer philosophy was well underway; however, expansion into Afghanistan's regions will require additional staff members and new trainers. In fact, the Priority Reform and Restructuring Process adds a new dimension to capacity building, requiring greater depth and reach across numerous Afghan regions.

It is estimated that more than 1,500 new personnel will be regionally staffed for tax collection and enforcement. As a result, many of the seminars administered under the AEG Program, will require reinstatement. In addition, the following steps should be followed to meet estimated training needs:

- Develop a Common Training Center within the Ministry of Finance, for both Revenue and Customs Administration – this will be crucial if an autonomous revenue authority for the Customs and Revenue departments will be installed in the coming two years,
- Appoint coordinators, curriculum development officers and core trainers for the proposed training center,
- Increase the number of resource persons within the Customs and Revenue departments,
- Develop new, and update any out-dated, training materials and
- Introduce a Tax Glossary in English, Dari and Pashto.



Budget and Operations Planning

Despite two decades of political conflict, the Budget Department within the Ministry of Finance continued to function. However, it operated at a very basic level and lacked the skills, knowledge and equipment to successfully perform most of the budget policy and expenditure management functions expected of a modern Budget Planning entity.

After performing initial examinations, it was evident that procedures for preparing and managing the Operating Budget were antiquated and unable to sustain Afghanistan's budgetary necessities. Taking a broad look at these deficiencies, the Budget Department did not have the ability to address the following issues:

- **Macro-fiscal Constraints** – In the past, the Operating Budget Department has not been required to seriously consider revenue constraints when preparing the budget.
- **Fiscal Discipline** – The Budget has been revised frequently by the President or the Ministry of Finance without reference to Cabinet (or Parliament). If Ministries ran short of funds, due to poor planning or weak budget control, they were able to request supplementation to balance the budget. As a result, a large proportion of the annual budget was set aside for such contingencies.
- **Government Policy Priorities** – The budget process provided little opportunity for the budget to reflect the government's policy priorities, to achieve savings or to reprioritize activities and expenditure. Most policies affecting the budget were decided without Ministry of Finance involvement.
- **Budget Performance** – The budget department took no interest in the efficiency or effectiveness of service provision by ministries, and there is no annual reporting by Ministries on their activities or achievements.
- **Transparency and Accountability** – Little, if any, information about the budget was made public. Ministers and agency heads are not routinely accountable for the performance of their ministries.
- **Sustainability** – There was no multi-year budget planning or forecasting. In particular, there was no capacity to take account of the future operation and maintenance costs of current development projects in the operating budget formulation process.

- Policy Analysis and Cost Benefit Analysis – The Operating Budget Department did not have capacity to analyze ministry policy proposals and consider alternative options.
- Provincial Equity – The encountered systems provided limited information on geographical distribution of resources, and there was no established process for the government to review data.
- Comprehensiveness – The Development Budget was formulated outside the Ministry of Finance, by a separate agency (the Afghanistan Aid Coordination Agency – AACA).

Finally, and at a more basic level, the physical conditions for Budget Department staff members were sub-standard. The offices lacked proper heating, along with reliable electricity, and traditional “computer work” was performed by hand or often typewriter. In addition, civil service salaries were extremely low, and most staff members lacked professional training (despite largely graduating from high school).

➤ *Reviewing and Restructuring the Budget Preparation and Analysis Functions*

A thorough review of the entire Budget Department was conducted after completing the 1382 (Afghan year) Budget, and the following items were identified as the ongoing reform agenda:

- Budget Department staff had little to no ability with respect to performing policy analysis or requiring line ministry budget proposals to be rigorously justified.
- The budget process focused on inputs, with little attention paid to the services and performance of line ministries.
- There was no capability within the Budget Department to examine methods, aimed at eliminating government activities or consolidating them into a more efficient, priority-concerned agenda.
- Few budget staff members were actively engaged in the work of the Budget Department (others lacked skills, lacked motivation or were not trusted by their supervisors).
- Most of the Operating Budget exercise focused on detailed intervention in budget execution, including spending controls (at the expenditure sub-code level) and issuing budget allotments in small amounts throughout the fiscal periods.

- Staff designated to perform Development Budget functions were under-tasked, as this function was undertaken by the AACA.

In light of this, proposed changes to the structure and staffing of the Ministry of Finance Budget Department were developed and submitted for consideration in June 2003. At the same time, an application to the Civil Service Commission for *Priority Reform and Restructuring* (PRR) approval as well as funding was prepared and approved in December 2003. In addition, the AACA Development Budget functions were formally transferred to the Ministry of Finance.

On a similar note, restructuring of Ordinary Budget functions was completed in August 2004, and several training programs were administered to Operating Budget staff members during the three-year program. Finally, the program has coordinated the procurement of both furniture and computer equipment, with the latter including a number of computer training programs.

In conclusion, the new Budget Department structure combines the Operating and Development Budget functions, while establishing a third tier, responsible for overseeing the preparation and implementation of both budgets. Promoting the idea of coordination, staff members for both budgets now work together in the same offices.

➤ *Reviewing Budget Appropriation*

This specific reform area focused on the Ministry of Finance *Chart of Accounts* system. After initial examination, it was evident that the paper-based accounting system's account codes did not conform to International Monetary Fund (IMF) standards of best practice in government accounting. As a result, introduction of the Afghanistan Financial Management Information System (AFMIS) provided an opportunity to reform these codes and directly respond to IMF recommendations and instruction.

Initially, there was resistance from Ministry of Finance staff members to any change in the original set up. In light of this, minor changes were initially introduced for the 1383 Budget, with a major review of the Chart of Accounts implemented in the second half of Afghan year 1383.

Budget reform measures ensured that the 1384 Budget was prepared in accordance with the new GFS-compliant codes for budget execution. The new system is more complex, with more levels of coding to allow detailed reporting of budget expenditures by organizational levels and sub-categories. In addition, the new codes reflect the program and project coding structures of both the Development and Operating Budgets (allowing a comprehensive reporting framework).

➤ *Reporting and Monitoring*

Prior to introducing the Afghanistan Financial Management Information System (AFMIS), the Accounting Department was largely responsible for preparing *government expenditure* reports, based on information provided by Afghanistan's Ministries. The original system was naturally inefficient, and numerous ministries ceased their regular submission of reports (a handicap to the thorough review of expenditures).

The Treasury Accounting System now provides reasonably accurate and timely information on actual expenditures (centrally and regionally), with expenditures in Kabul recorded immediately and regional expenditures recorded within the subsequent monthly period. The Budget Reform Project has therefore developed a system of regular, monthly reporting (using AFMIS data) to support the Budget Department's tasks.

The aforementioned reports contain a summary of total budget expenditure by object code, along with detailed expenditure reports (month-to-month) for each Afghan ministry. These reports were used extensively by the Ministry of Finance Budget Committee, during its mid-year examination of the 1382 and 1383 annual budgets. In fact, these reports facilitated the adjustment process, which accounted for each ministry's ability to operate within its means.

➤ *Allotment Processing*

Under current Budget Law provisions, the Budget Department and Afghanistan's central ministries are obligated to issue authorized quarterly allotments to provincial offices before expenditures can be made. Over the past two decades, procedures for authorizing such provincial expenditures, communicating budget information to regional offices and ensuring that sufficient cash amounts were available for the local government bank branches (to meet expenditure needs) became largely ineffective.

As a direct result, regional government employees regularly did not receive salaries for up to six months (sometimes longer), and the ministerial offices in the regions, responsible for providing services to provincial areas, had little to no financial means. This was a serious problem for the new government, which needed support from the country's regional citizens.

In 1382, an allotment process was implemented through AFMIS for the first time. In addition, the outdated system of submitting paper forms for expenditure authorization continued. In fact, after the 1382 operating budget was approved, it took more than two months for provincial offices to receive their Q1 spending allotments. This issue was subsequently highlighted by the World Bank and became a priority item.

For the 1383 Afghan year, major reforms to the allotment system were proposed, but there was strong resistance to any changes in the established process (from Ministry of Finance, line ministry and provincial staff). The Director General of Budget therefore adopted a more gradual approach to these reform measures, with firm deadlines being applied to the submission of ministerial allotment requests. Subsequently, most ministries improved their compliance rate, although many consistently missed deadlines.

Finally, for the 1384 Afghan year, the IMF's *Staff Monitored Program* set a benchmark for the establishment of a fluid provincial allotment system, which placed greater emphasis on this matter and led to an increase in reform. Allotments for Q1 were available to provincial offices by the second week of the new fiscal year (a significant improvement from prior years). Implementation of the new Budget Law provided an additional opportunity for more reform.

➤ *Assisting the Ministry of Finance with the 1382, 1383 and 1384 Budgets*

Preparation of Afghanistan's 1382 Budget was already in progress when the USAID program began. Nonetheless, a number of briefings and fiscal analyses were prepared for that year's official *Budget Hearings*. This included a comprehensive Budget document, which outlined both the Operating and Development Budgets.

In 1382, the Deputy Minister of Finance conducted a review of the budget using actual expenditures and data prepared by the project's staff members (this represented the first time up-to-date information was available for reference by the Budget Department). The exercise formally reviewed ministerial budget performance and resulted in a number of adjustments to the already-approved budgets (this instituted a more realistic approach to the estimation of ministerial fund utilization).

Furthermore, a *budget formulation database* was developed using MS Access to support the preparation of the 1382 Budget, and it has subsequently been used in the development of both the 1383 and 1384 Budgets. The database records ministerial budget bids, advisor recommendations as well as Budget Committee decisions. In addition, the system generates a number of reports (to aid in the decision-making process) and facilitates the development of appropriation schedules for *budget decree formulation* and *budget adjustment tracking*.

With respect to the 1383 Budget, the BearingPoint team provided direct guidance and assistance to the Budget Department's Director General. The team produced detailed background information and briefing notes for each ministry, which were subsequently used as reference documents during the *Budget Hearings*, tracked decisions on a daily basis and monitored aggregate decisions against the budget envelope.

In late 2004, the Budget Committee reviewed the 1383 Budget, once again making extensive use of data reports on actual expenditure and staffing. However, unlike prior years, Budget Department staff members assumed greater responsibility in preparing briefing materials and administering the review sessions. Subsequently, the review resulted in major budget reductions for most ministries and an overall reduction in the size of Afghanistan's Operating Budget, based on actual spending within the first six months of the Afghan year.

With respect to the 1384 Budget, the BearingPoint team provided advice to the Minister of Finance on proposed fiscal targets for that year. On the basis of this advice, the Minister and Budget Committee members adopted a tight fiscal position for the Operating Budget, largely based on conservative revenue estimates and the desire to limit ongoing dependence on donor funding. As a result, the growth of annual budgets for most ministries was limited to less than 15%. Finally, the budget decree (with accompanying schedules) and a press release explaining the GOA's commitment to instill tight fiscal management were prepared.

➤ *Guidance for Future Reform*

Throughout the term of the Budget Reform Project, significant progress has been made in a number of areas. This includes broad-based modernization of the Budget Department itself, a fundamental upgrade of staff member skills as well as the integration of both the Operating and Development budgets. At the same time, the Budget Department was very basic in all aspects of its operational capabilities, so there is great need for ongoing development of both internal operations and staff skills. This section introduces those areas and describes possible remedies.

■ *Building Policy Capacity within the Operating Budget Department*

Restructuring of the Budget Department under the Priority Reform and Restructuring (PRR) Program was intended to strengthen the department's ability to better address expenditure policy issues, provide sound advice to government officials or agencies on the effectiveness of government expenditures as well as propose options for the better use of public resources.

This all-encompassing view has still not been achieved. One fundamental reason for this is that the operational side of the Budget Department continues to absorb a majority of the effort and does not permit sufficient time for policy analysis. A second reason is the current staffing composition, which is a product of recruitment from prior Budget Department employees, who unfortunately do not have the requisite education or professional skills to steer the department's internal reform.

■ *Integration of the Operating and Development Budgets*

Currently, although both budget functions are located within the Budget Department, the Development Budget continues to be managed by a UNDP-funded team of advisors and national staff, while most Operating Budget reform is under the Ministry of Finance's umbrella. Furthermore, the size and complexity of the Development Budget (in comparison to the Operating Budget), along with the heavy involvement of donors, will make it difficult to fully integrate both budgets.

This is another issue that will require significant amounts of time to be resolved. That being said, progressive steps should be set in place, including a formal review of staffing, funding arrangements and the allocation of budget advisor resources across the Budget Department (in an effort to reduce the separation of management and reporting between the Operating and Development areas).

Finally, long-term integration of these budgets will require a comprehensive review of the budget-planning framework, in order to incorporate recurrent government activities into the national framework and extend program classification concepts to the operating budget activities of Afghan ministries.

■ *Medium Term Expenditure Framework*

Afghanistan's Budget Department was scarcely able to formulate an annual repeating budget, much less an estimated budget for the next three years (as required by the draft Budget Law). Considerable time and effort will be required to establish forward estimates of repeating expenditures, required for a medium-term expenditure framework. Current Budget staff members within the line ministries and Budget Department do not have the capacity to do this, but a medium-term framework could be developed through advisory assistance. It is highly suggested that Budget Department staff understand and have the capacity to maintain the "framework," prior to the start of such a program.

■ *Passage of new Budget Law*

A new Budget Law has been in consideration for more than one year. Passage of this law would provide strong justification, along with a solid legal basis, for additional reform of the Budget Department and its management capabilities.

■ *Budget Timetable for 1385*

When the Budget Reform Project came to an end, elections for Afghanistan's National Assembly were scheduled for September 2005. According to that schedule, the National Assembly will be in place when the 1385 Budget is formulated. Under constitutional

terms, the National Assembly approves all proposed budgets; therefore details with respect to the submission and subsequent debate of a proposed budget need to be delineated beforehand. At the same time, the Ministry of Finance should be proactive in ensuring smooth passage of future budget appropriations through the Assembly.

The Ministry of Finance should also avoid recourse to a specific constitutional provision, which allows the prior year's budget to continue, if a delay in the passage of the new budget occurs. This offers an easy solution but poses a serious problem for government administration. This scenario could disrupt the business of government, delay the implementation of new programs and undermine budget discipline.

- *Review PRR Appointments*

Periodic reviews of all PRR appointments within the Budget Department were originally scheduled to take place. However, due to changes in senior staff, no reviews have been conducted, and the actual criteria have not been established. Although the review process would most likely be a simple redistribution of staff members within the same office, it would serve as a reminder that higher levels of performance are expected and that all positions are not guaranteed.

- *Reform of Allotment Procedures*

Passage of the new Budget Law should eliminate some of the legal provisions, which are currently constraining reform of the allotment system. Changes that have taken place to this date are largely insufficient, and there is room for major reform. For instance, paper-based processing should be eliminated altogether (one allotment plan from each ministry at the beginning of the year should be adequate). Finally, extension of the Afghanistan Financial Management Information System (AFMIS) to the provinces should also alleviate a number of the system's current limitations.

Afghanistan's provincial budgeting and allotment systems raise fundamental questions about the relationship between the central government and provincial administrations, along with the equity of public resource distribution. A more efficient system will only be possible if changes are made in the sphere of inter-governmental relations, something that was beyond the scope of the Budget Reform Project.

- *Pay and Grading Review*

The World Bank is currently reviewing all civil service grade structures and pay levels, with the aim of proposing a simplified system and pay raises. Depending on the proposed salaries, these changes would have a major impact on the Operating Budget, and the Budget Department must be involved in estimating the impact of various pay options

before any decisions are made. If a new “Budget Policy Unit” is established, this would be a logical task for its agenda. Finally, the implementation process for new salary scales should also be considered. For example, a phased approach – linked to PRR performance requirements – would reduce total costs and promote efficiency.

▪ *Review of Pensions and Benefits*

The World Bank is also reviewing the civil service pension system, and the examination may lead to a proposal for changed pension entitlements. This issue was introduced to Afghanistan’s Cabinet, and a number of ministers rejected the option for modest pension increases. Instead, new rates were granted for certain pensioners, and this led to an annual increase of 1,500%. In the future, the Budget Department needs to be involved in any discussion on the reform of civil service or military pensions.

▪ *Defense Budget Reform*

Afghanistan’s Defense Budget is the second largest item within the budget, and there are a number of serious budget policy issues that need to be examined in light of this. For instance, the DDR process significantly reduced the number of former Afghan Military Forces (AMF) in Afghan year 1383, and funding provided in 1384 was intended to cover a share of the costs associated with the new Afghan National Army (ANA). As was later discovered (and estimated), 48 percent of the AMF force, which was being paid a salary, did not actually exist.

The risk is that the Afghan Government is now paying ANA salaries, with the same process used for the AMF, so fraudulent payments to “ghost workers” could take place again. In fact, the Ministry of Finance Audit Department monitored the AMF “de-financing” process, and it should now endeavor to refinance the ANA (either by the Audit Team or another viable agency or program). Finally, here are a number of additional concerns with respect to the Defense Budget:

- Major items in the ANA component of the Defense Budget are 1) salaries beyond the US government’s monthly funding cap and b) the cost of food for ANA personnel. Food expenses are larger than the salary expense, and the cost is \$2.70 per day, per person. The sustainability of this provision was not considered in the budget discussions and needs to be re-examined.
- The budget for 1384 was based on ambitious targets for ANA recruitment over the year. Recruitment targets have not been achieved in the past and may not be achieved this year. If recruitment is slower than expected, the budget for salaries, food and other support costs will not be utilized. Unused salary funds should not be automatically transferred to other uses within Defense, as was done in 1383.

- A large part of defense spending will continue to be funded by the US government; however, the United States intends to transfer these costs to the GOA, progressively over the next few years. When the BearingPoint Budget Reform Project came to an end, there was still no agreement on a transfer. When a transfer does take place, the total pressure on Afghanistan's budget will be considerable.

➤ *Before and After Photographs*



Prior to 2003, Budget Department work was based entirely on paper ledgers and forms.



In 2004, Budget Department work became modernized and largely automated.



In 2003, Budget Department offices lacked the proper infrastructure to operate in a well-functioning, modern capacity.



Budget Department offices are now equipped with proper furniture and IT equipment.

Fiscal Policy, Information Technology and Data Collection

➤ Revenue Analysis

At the onset of the Afghanistan Economic Governance Program, technical assistance was provided to the Planning Division of the Revenue Presidency as well as the Ministry of Finance to determine the best course of action for Afghanistan, in light of a) revenue needs and b) revenue estimation.

Revenue estimation is necessary because the GOA must plan for social policy spending, achieved through budget processes – as noted in the prior section. One example of a common need for any society is the availability of water for both irrigation and drinking. Due to needs such as these, a government may decide if it wants to build an irrigation system for farmers or water treatment plants for residents. There is one common link: *both of these projects will require funding.*

This funding is most likely to come through taxation or administrative fees, such as a tax on business profits or customs duties – also noted in prior sections. Lacking a proper system to raise these funds, a government cannot pay for the provision of any services, resulting in a dependence on donor aid. Revenue estimation is the precursor to this consideration, as it is a prerequisite for a) understanding social policy needs and b) knowing how much money is required.

In light of this framework, the “Revenue Estimation: A Practical Guide to the Concept with Techniques” guideline was prepared for the Islamic Republic of Afghanistan and details practical methods of predicting revenue, commonly known as revenue estimation. As an international best practice, proper revenue estimation methodologies should provide the GOA with the best available knowledge of how much money is needed. Finally, the guideline is a practical approach to this fiscal obligation and was designed for both novice readers and more advanced practitioners.

Moreover, the guideline serves as a broad introduction to the revenue estimation process for the novice estimator. More experienced revenue estimators may not require this level of detail; however, someone unfamiliar with these concepts will prosper from its subject breadth.

Finally, the document aims, at a high level, to promote sound revenue estimation principles, in order to answer policy questions from the President, Ministers or other senior GOA members. Revenue estimation will play a critical role in Afghanistan’s future, since it will identify needs and sustain fiscal policy making when donor assistance is reduced or discontinued completely.

To understand the document's schema and depth of scope, an outline of its contents has been included here. At the same time, please note that each section examines revenue estimation in a framework of international best practices, subsequently applied to real world examples for Afghanistan:

- Introduction to the Revenue Estimation Process
 - What is revenue estimation?
 - Why is revenue estimation important?
 - Why forecast revenue?
 - Who is responsible for revenue estimation?
 - What is involved in preparing a revenue estimate?
 - What is the difference between liability and collections?
 - What are the primary tasks of a Revenue Estimator?
 - How long does it take to produce revenue estimates?
 - How accurate are revenue estimates?
 - Examples of different tax systems, their liability and cash collections
 - What is the best approach to estimate and forecast revenue?
- Purpose of the Revenue Estimation Process
 - Providing timely and accurate information to policy makers
 - Budget cycles
 - Public Awareness
- Key Ingredients to the Process
 - Access to adequate data
 - Building an adequate data set
 - Accuracy
 - Transparency
 - Documentation
 - Common sense approach
- Performing a Revenue Estimate
 - Theories behind revenue estimation
- Verifying a Revenue Estimate
 - Definitions and
 - Reasonableness.

➤ *Information Technology*

At the beginning of the AEG Program, it was clear that the Ministry of Finance would need an infrastructure reform schema, aimed at installing a reliable, stable and secure network. Prior systems, which included infrastructure wiring and project servers, were totally inadequate and incapable of sustaining a properly functioning ministry. As a result, the project a) designed, b) implemented as well as c) maintained a modern and more secure network.

Bringing *Information Communication Technology* – ICT – to the Ministry of Finance was a formidable challenge. As assumed, the MoF had very low levels of physical infrastructure, consisting of minimal and sub-standard office equipment, damaged buildings as well as no reliable network connectivity. By installing a brand new wiring infrastructure, employees prospered from a pioneer system, which had never been seen before. The following is a small glimpse of its uses:

- Client and server communications – domain authentication and access to various department resources and
- Secure internal and external communications – VLAN, e-mail @mof.gov.af and Internet services.

An added obstacle was the lack of sound IT a) strategies, b) policies and procedures or c) skilled professionals. After meeting with senior personnel and department heads to better understand the MoF's functions, mission and general business goals, the project designed a modern Information Technology strategy, aligned with the short and medium-term goals of the MoF as well as capable of adapting to its long-term needs.

To meet these pre-determined goals, the project collaborated with the United States Army, which funded a number of procurements:

- Revenue – Mustofiat Program
 - 20 Dell Desktops loaded with XP Pro, Norton Anti-Virus and MS Office
- IT Department
 - 5 Dell Servers, PIX Firewall, Cisco VPN solution, Internal security devices (Blue Coat and Blue Anti-Virus) as well as Cisco Switching Technology
- Training Department
 - 40 Dell Desktops loaded with XP Pro, Norton Anti-Virus, MS Office and Dell Power Edge Server.

As a measure of progress, the benefits were immense. The MoF was able to remove unbranded and unlicensed computers, which were causing enormous security problems, like worms and other security vulnerabilities. A streamlined system also established secure communication with the regions as well as the world. The MoF will now be able to use technology, such as Virtual Private Network (VPN), for remote users using Email and other IT systems, through a secure tunnel.

The project also designed a number of policies, critical for eliminating network risk. A list of these has been included here:

- 3rd Party Agreement,
- Firewall,
- Internet Usage and Security,
- Email Usage,
- Help Desk Support and
- Computer Usage.

These policies were designed to govern the MoF's IT systems, and the development as well as proper implementation of these rules was truly helpful, as they bolstered communication reliability and reduced the risk of potential security breaches from "human-factor" error. This usually includes revealing information to a) unknown or b) unauthorized sources as well as c) the insecure or improper use of the Internet in general.

At the same time, these policies defined the MoF's critical assets and methods for protecting and preserving them. All users must now read these policies, and they benefit from an increased awareness and ability to handle the following:

- How sensitive information must be handled,
- How to properly maintain your IDs and passwords, as well as any other accounting data,
- How to respond to a potential security incident or intrusion attempts,
- How to use workstations and the Internet in a secure manner and
- How to properly use the corporate e-mail system.

Finally, capacity building was a focal point for the project, as local staff was trained for self-sustainability. The following is a list of these training areas:

- Firewall installation, configuration and monitoring,
- Help Desk support and creation,

- Windows 2000 / 2003 server installation and configuration,
- Network + and A+,
- Cisco routing and switching configuration as well as
- Basic to advanced trouble-shooting techniques for Windows XP.

➤ *Data Collection and Analysis*

As an amalgamation of the prior two sections, “data collection and analysis” is formed by merging revenue collection with data storage and analysis. Prior to the Afghanistan Economic Governance Program, methods for gathering and submitting Customs revenue information were primitive at best. The original manual, which was being used in Afghanistan’s provincial Customs houses and border posts, did not contain import or export data, and as a medium, was unable to include trade statistics.

To aid the Ministry of Finance modernize and streamline Customs revenue collection, the project designed and implemented the Afghanistan Customs Clearance Document – ACCD – form, a reliable medium for declaring merchandise a) imported into or b) exported from Afghanistan. At the same time, the form functions as an integral source document for the storage of data.

Moreover, a user-friendly spreadsheet was designed in the short-term to capture and store all ACCD information. Keeping a novice user in mind, the sheet did not include the following:

- Automatic field value calculations,
- Detailed import or export descriptions,
- Error detection or
- Control and correction mechanisms to reconcile trade statistics or Customs revenue totals.

These processes served as stepping-stones for more advanced techniques, and in August 2004, a revised spreadsheet, integrating the abovementioned items, was installed in the following sites:

- Kabul Customs Office,
- Kabul International Airport,
- Jalalabad Customs Office,
- Torkham Border Post,
- Mazar-e-Sharif Customs Office,

- Andkhoy Customs Office,
- Herat Customs Office and
- Kandahar.

Installation of this spreadsheet was a big step for the electronic capture of a) Customs data as well as b) Afghan trade statistics. Despite the initial gains, it was a medium-term mechanism, aimed at establishing a preliminary system. As a third stage in the reform process, the project introduced the EUROTRACE - Comext system.

EUROTRACE is a powerful and flexible software application, designed by the European Union, which provides both the structure and tools for the management of statistical data. At the same time, it is commonly used as a production system for the integration, validation and management of statistical data sets. Finally, it stores data history, enabling the efficient exchange of data between applications, while being suitable for database administrators requiring increased functionality.

The platform consists of the following three applications:

- DBMS – enabling Customs declarations to be stored, while generating automated subsets of data,
- Data Editor – capturing data and editing or reconciling incorrect data,
- Comext – used in the automated generation of reports.

At the conclusion of the project, the *Data Editor* system had been successfully installed in the following sites:

- Kabul Customs Office,
- Kabul International Airport,
- Jalalabad Customs Office,
- Torkham Border Post,
- Mazar-e-Sharif Customs Office,
- Andkhoy Customs Office,
- Konduz City Customs Office,
- Khost Customs Office and
- Herat Customs Office.

At the same time, the Customs Data Unit – CDU – in Kabul City employed both the DBMS and Comext systems.

EUROTRACE has enabled the Ministry of Finance to generate trade statistics as well as monthly and quarterly Customs revenue summaries, information which ties into the revenue estimation and planning function of the MoF. In fact, these reports are submitted directly to the Deputy Minister of Finance on a regular basis, providing timely data as well as promoting coordination and information sharing. For the first time in Afghan history, trade statistics have been published on the MoF website, increasing public awareness and fostering transparency. Trade statistics can now be found here:

- <http://www.mof.gov.af/english/customs.htm>.

As a conclusion, the project was very successful in installing both short-term and medium-term systems. In the coming years, as *technical skills* increase, these systems can be enhanced to meet the pace of new *information gathering* and *analysis* needs. As a result, these mediums are adjustable for Afghanistan's long-term needs.

➤ *Mustofiat Project*

At the onset of the AEG Program, Afghanistan's fiscal reporting system was inefficient and largely fragmented in nature. In light of this, the Ministry of Finance was unable to collect sufficient revenue and expenditure information from each province. These deficiencies resulted in a number of operational obstacles, which impaired budgetary allotments to all regions.

The *Mustofiat Program* was therefore established, assigning local Financial Officers to each province and deploying expert Managers to six (6) *regional centers*. These managers are now responsible for monitoring operations and guiding capacity building tasks. Here is a snapshot of the project's reform areas:

- *Objectives*
 - Facilitate national integration of a fiscal reporting system,
 - Ensure the flow of budget information from MoF to provinces (and vice versa),
 - Guide the Financial Officers in collecting *expenditure* and *revenue* data (as well as processing data for adequate reporting),
 - Eliminate communication obstacles between the MoF and mustofiats, by introducing new equipment and linking methods,
 - Establish standard operating procedures for data quality and timely reporting,
 - Establish computer rooms in each province for the drafting of reports and
 - Promote capacity in terms of computer training and efficient reporting methods.

Due to the Mustofiat Program, Afghanistan now has thirty-eight trained Financial Officers, with operational skills in a) budget as well as b) revenue and expenditure reporting. At the same time, numerous training seminars have been held in Kabul City to promote awareness and build regional, staff capacity. Capacity building has also included the delivery and installation of computers and hardware to all mustofiats, prerequisites for the timely submission of revenue and expenditure figures, as well as the installation of standard operating procedures in almost all functional areas. Finally, furnished computer rooms have made all six regional centers eligible for the Free-Balance System.

As a corollary of this reform, the Ministry of Finance is now in a position to justify its expenditures to the donor community and the Afghan Reconstruction Trust Fund. At the same time, the program has contributed to the a) identification of tax categories, b) installation of regional hubs for the Taxpayer Identification Numbering System, and c) the establishment of functional, budgetary units.

Financial Technical Sector

- Da Afghanistan Bank – *Central Bank*
- Afghanistan's Commercial Banking Sector

Introduction

Financial Technical Sector reform represented a major accomplishment for USAID, *Da Afghanistan Bank* – DAB – BearingPoint and the *Afghanistan Economic Governance Program* in general. Employing a *holistic* approach to the numerous and wide-ranging reform areas, BearingPoint managed and administered USAID technical assistance, in close cooperation with the International Monetary Fund, by focusing on the functional relationship between DAB's many parts and its performance as a whole.

Having been the primary donor within DAB, USAID can now use the *Banking Reform Project* as a model for future reform efforts in other transitional economies. In *post-conflict governance*, a strong central bank as well as a reliable commercial banking sector are fundamental prerequisites for a properly functioning economy. Furthermore, they need to be considered integral parts of both *government* and *democratic* reform.

USAID supported the earlier *currency conversion*, as it was a foremost priority and foundational medium for the central bank to measure actual *amounts of currency* within the country and consequently manage overall inflation. In line with this aim, the Bagram Branch, situated on a US Army base, was eventually established as part of the process for promoting new Afghan currency and processing a substantial in-flow of money by the US Army, a proponent of using Afghanistan's new currency. Moreover, the formal auction process was enhanced and used to facilitate the *sterilization* of money, thereby providing a fundamental link in the cyclical management of *monetary supply* and *exchange rate management*.

Analogous to the concept of *Olympic Rings*, reform of DAB's core areas evolved within the previously mentioned *holistic* approach. Since true progress for a central bank can only be measured by looking at the sum of the parts, the core areas were evaluated in terms of inter-dependence and their individual contributions to the larger output and financial management function of the central bank. Each of the following Financial Technical Sector reform sections corresponds to one of these core areas and should be read in the *context* of a larger financial management system.

In following this *holistic* approach, the *Afghanistan Economic Governance Program* was able to effectively strengthen the basic structures and processes inherent to DAB, thereby setting the stage for the follow-on *Economic Governance and Private Sector Strengthening Program*, which will develop human resource capacity as well as internal, private sector markets. Finally, a *patient and persistent* methodology guided all of the reform components and led to distinguishing results, such as the location and verification of international reserves, along with the production of the first Balance Sheet in 8 years.

Macro-Economic Reform

The Macro-Economic Reform Project was tasked with establishing a Macro-Economic Policy Department – MPD – capable of a) supporting, b) designing and c) monitoring a discrete monetary policy program. At the close of the project, the MPD was successfully analyzing the monetary impact of banking systems on economic growth and estimating both money demand and prices, two critical factors in economic management. Moreover, the MPD was a) collecting and b) analyzing a wide range of statistics, including:

- Money supply,
- Emission,
- International reserves,
- Exchange rates,
- Banking reserves,
- Domestic assets and
- Inflation.

At the same time, the MPD was advising policy makers on effective approaches for sound monetary policy. Trained Afghan staff members were designing policy parameters, in order to stay within pre-determined economic targets, and train-the-trainer sessions became the medium for generational capacity building. As a conduit to meet these goals, a high level of coordination was required among a number of agencies.

For instance, the Macro-Economic Reform Project collaborated closely with the International Monetary Fund – IMF – and prospered from its training activities. At the conclusion of the project, DAB staff members were collecting and submitting day-to-day reporting requirements directly to the IMF itself, a good measure of self-reliance and accountability. In addition, the MPD took a lead role in managing the Technical Coordination Committee – TCC – by a) providing its secretarial function, b) preparing macro-economic updates for each of its meetings as well as c) highlighting general progress towards benchmarks and policy actions.

As part of the ongoing collaborative effort with the International Monetary Fund, the project facilitated DAB's participation with and support of the IMF Staff Monitored Program - SMP. Afghanistan's SMP program, like many other countries, *is an informal and flexible instrument for dialogue between IMF staff and a member nation on its economic policies*. As such, the Macro-Economic Reform Project supplied IMF delegations, on a quarterly basis, with relevant data and analyses. This information measured progress towards the SMP program's a) goals, b) pre-defined benchmarks and c) general areas of reform.

➤ *Monetary Policy and Program*

As with many other projects under the Afghanistan Economic Governance Program, the Macro-Economic Reform Project initially assessed the macro-economic capacity of Da Afghanistan Bank and subsequently employed the following schema:

- Designing a reform plan,
- Obtaining concurrence from senior management and
- Implementing the plan, within the larger policy making process.

By the conclusion of the project, the majority of all recommendations had been addressed through enhanced procedures or the implementation of brand new policies. In the following paragraphs, these measures will be outlined, thereby illustrating the depth and scope of reform.

As noted in the graphs at the end of this Macro-Economic Reform section, the monitoring and tracking of exchange rates was an integral part of the project. This was done on a daily basis by DAB staff members, who were trained in the methodologies of exchange rate analysis. Based on this analysis, recommendations were made to DAB senior management, by way of daily updates as well as formal bi-weekly meetings.

Exchange rate levels were discussed with policy makers, with the realization that it will almost certainly be necessary to devalue the Afghani to improve competitiveness – by establishing the relative price incentives to increase production of exports and import substitutes. However, in the current environment, with overwhelmingly inadequate institutions and infrastructure - especially power - significant expansion of output is not realistic. As a result, the decision was made to stabilize the nominal level of the Afghani and use this as a means to reduce inflation.

At the same time, the general compilation and production of monetary statistics is now a routine function of the Monetary Policy Department (MPD). Detailed reports are prepared on a quarterly basis – for senior management and as a reference at Supreme Council meetings. In addition, daily snapshots of *currency in circulation* figures are produced, in the same fashion as the exchange rate levels mentioned above. Finally, a discrete set of *monetary survey statistics* is compiled and submitted to the IMF on a monthly basis.

The process for collecting monetary survey statistics was a success story, in the sense that it began from the bottom and is now a regular function. In conjunction with the IMF, survey instruments to capture Balance of Payment – BoP – information were designed, implemented and have now resulted in a reliable data collection system, which could be considered advanced.

These surveys have been performed for banks, moneychangers, airlines, hotels, embassies as well as donor inflows. In addition to greater BoP data, this tool is a key medium for enhancing monetary policy, based on the a) international trade and b) financial data of the Afghan economy.

As noted, a plethora of monetary statistics is now being collected by the MPD. In light of this, a formal process was established to capture and store this information. Since the second year of the project, a database has been regularly updated and used to carry out MPD analyses and support policy recommendations. In order to meet changing DAB demands, the database was installed on an interim basis and is ready to merge into a DAB-wide information platform. Finally, the same monetary statistics are published in the widely-disseminated DAB *Quarterly Statistical Bulletins*.

➤ *Reserve Asset and Treasury Management*

Reserve asset and treasury management were also fundamental pieces of reform for DAB, leading to an increase in both performance and income. Here is a listing of the numerous reform tasks under this area:

- Identified all DAB accounts held in foreign banks,
- Designed and implemented steps to release these funds back to DAB,
- Initiated Reserve Management Policies, which created an Investment Committee and established Lines, Limits and Benchmarks,
- Installed the Reuters Dealing System, which now links DAB and the national currency to the global securities and trading markets,
- Established a Securities Safekeeping account, which allows for the warehousing of securities, such as US Treasury obligations and British Gilts,
- Improved DAB portfolio returns significantly, by way of currency restructuring, the acquisition of 3 and 6-month term deposits as well as the purchase of short-term US Treasury Bills and Notes,
- Facilitated the growth of foreign reserves and portfolio efficiency.

The table on the following page reflects a *monthly position report* on the amount of Afghanistan's foreign reserves as well as the investment return:

| Growth of Foreign Reserves and Annualized Income - expressed in US Dollar Equivalent | | | |
|--|----------------|--|------------------------------|
| Date | Total Reserves | Annualized Return on Deposits and Securities | Annualized Income Production |
| 1/31/2004 | 829,347,363 | 1.37% | 6,837,962 |
| 2/28/2004 | 819,962,500 | 1.42% | 6,815,625 |
| 3/31/2004 | 881,844,461 | 1.44% | 7,560,444 |
| 4/30/2004 | 901,239,557 | 1.73% | 9,017,754 |
| 5/31/2004 | 961,271,290 | 1.71% | 10,112,821 |
| 6/30/2004 | 960,717,679 | 1.69% | 10,249,774 |
| 7/31/2004 | 1,013,115,030 | 1.97% | 12,932,388 |
| 8/31/2004 | 1,138,477,490 | 1.92% | 13,566,922 |
| 9/30/2004 | 1,135,857,791 | 1.99% | 13,826,447 |
| 10/31/2004 | 1,223,222,565 | 1.98% | 15,221,757 |
| 11/28/2004 | 1,301,909,906 | 1.84% | 15,226,537 |
| 12/30/2004 | 1,331,273,629 | 2.58% | 22,906,541 |
| 1/27/2005 | 1,338,956,920 | 2.49% | 22,758,243 |
| 2/28/2005 | 1,358,115,537 | 2.45% | 23,665,048 |
| 3/31/2005 | 1,324,033,326 | 2.94% | 27,622,579 |
| 4/30/2005 | 1,363,830,367 | 2.94% | 28,153,115 |
| 5/31/2005 | 1,379,851,376 | 2.74% | 27,182,478 |
| 6/30/2005 | 1,374,611,189 | 2.58% | 24,996,011 |
| 7/31/2005 | 1,400,589,320 | 2.89% | 29,031,516 |
| 8/31/2005 | 1,462,705,861 | 2.87% | 30,364,851 |
| 9/30/2005 | 1,555,106,175 | 2.76% | 30,960,469 |
| 10/31/2005 | 1,519,973,938 | 3.16% | 34,674,882 |
| 11/30/2005 | 1,575,589,078 | 3.01% | 34,777,687 |
| 12/31/2005 | 1,586,384,430 | 3.30% | 36,031,793 |
| 1/31/2006 | 1,732,581,962 | 3.40% | 41,234,999 |
| 2/28/2006 | 1,769,608,461 | 3.31% | 41,961,366 |

➤ *Capital Market Development*

Afghans had no means of measuring formal market rates of interest, as they were precluded from selling public debt. To overcome this challenge and provide the banking community with benchmark rates of interest, by which both assets and liabilities could be priced, a short-term financial instrument, issued and auctioned by DAB, was designed. As a medium, it represents the first short-term financial instrument auctioned to licensed commercial banks and is solely denominated in Afn notes. It provides:

- A vehicle, whereby licensed banks can better manage their liquidity,
- A tool for DAB to conduct its monetary policy operations, by controlling and fine-tuning liquidity levels within the banking sector and
- A market-driven interest rate structure, used as a mechanism for guiding the credit market in Afghanistan.

DAB has been offering the *overnight* Capital Note, since September 2004. In addition, 30-day notes are now being auctioned on a weekly basis, with the results of these auctions routinely published to the commercial banks. For more information on Capital Notes, please reference the graphs at the end of this Macro-Economic Reform section.

The former DAB Governor at the
official opening of the Capital
Notes Program.



➤ *Currency Auctions*

DAB dollar auctions represent key tools for monetary policy, and the *Market Operations Department* has both designed and installed improvements in the overall administration of auction processes. As a result, a negotiated currency auction was implemented, whereby the USD is sold to licensed moneychangers.

The DAB auctions offer a means to both control the overall currency in circulation and lend stability to the Afghan exchange rate. In February 2006, the negotiated methodology was changed to a *dutch auction format*, whereby bids are initially solicited and then granted in terms of descending price, until the desired auction amount is ultimately reached in the process.

Finally, the DAB auctions commenced on March 4, 2003. By December 31, 2005, 115 had been successfully held, totaling \$919,863,000 and sold at an *average rate* of 48.85. Due to this process, more than Afn 44.9 Billion has been sterilized. On the following pages, please find summary tables for these auctions:

| 2003 | Rates | | Auction in 000's | |
|-----------|----------------------|-----------------------|------------------|-------------------|
| Month | Average Auction Rate | Average Exchange Rate | USD Sold | Afghanis Received |
| March | 51.29 | 51.59 | 28,000 | 1,436,120 |
| April | 49.49 | 49.89 | 38,999 | 1,930,061 |
| May | n/a | 48.69 | 0 | 0 |
| June | 48.87 | 48.98 | 3,000 | 146,610 |
| July | n/a | 48.73 | 0 | 0 |
| August | 48.40 | 48.93 | 5,000 | 242,000 |
| September | 49.26 | 49.45 | 10,000 | 492,600 |
| October | 48.83 | 49.14 | 10,000 | 488,300 |
| November | 48.69 | 49.04 | 8,250 | 401,693 |
| December | 48.27 | 48.58 | 10,790 | 520,833 |
| Totals | - - - | - - - | 114,039 | 5,658,216 |

| 2004 | Rates | | Auction in 000's | |
|-----------|----------------------|-----------------------|------------------|-------------------|
| Month | Average Auction Rate | Average Exchange Rate | USD Sold | Afghanis Received |
| January | 48.96 | 49.13 | 30,850 | 1,510,416 |
| February | 49.67 | 49.84 | 18,860 | 936,776 |
| March | 49.86 | 49.97 | 57,220 | 2,852,958 |
| April | 50.26 | 50.19 | 21,150 | 1,062,999 |
| May | 49.97 | 50.03 | 24,800 | 1,239,256 |
| June | 48.59 | 48.61 | 36,500 | 1,773,597 |
| July | 46.79 | 46.83 | 34,448 | 1,611,721 |
| August | 44.93 | 45.79 | 13,250 | 595,303 |
| September | 45.18 | 45.34 | 24,900 | 1,125,091 |
| October | 45.65 | 45.83 | 16,850 | 769,285 |
| November | 46.49 | 46.27 | 20,300 | 769,285 |
| December | 47.94 | 48.17 | 27,950 | 1,339,940 |

| 2005 | Rates | | Auction (in 000's) | |
|-----------|----------------------|-----------------------|--------------------|-------------------|
| Month | Average Auction Rate | Average Exchange Rate | USD Sold | Afghanis Received |
| January | 49.37 | 49.53 | 35,000 | 1,727,800 |
| February | 49.57 | 49.73 | 30,000 | 1,487,000 |
| March | 48.67 | 48.90 | 39,546 | 1,924,845 |
| April | 49.16 | 49.28 | 28,000 | 1,376,550 |
| May | 49.88 | 49.96 | 49,850 | 2,486,708 |
| June | 50.11 | 50.10 | 48,000 | 2,405,280 |
| July | 49.90 | 49.83 | 51,700 | 2,579,977 |
| August | 49.21 | 49.28 | 35,950 | 1,769,254 |
| September | 49.15 | 49.17 | 46,550 | 2,288,136 |
| October | 48.78 | 48.79 | 34,600 | 1,687,710 |
| November | 49.36 | 49.25 | 33,700 | 1,663,504 |
| December | 50.17 | 50.08 | 45,850 | 2,295,591 |

Finally, detailed *Quarterly Economic and Statistical Bulletins* are now being prepared on a regular basis. The process began in 2003 and has steadily improved, adding more depth to the data and its analysis. These bulletins are widely disseminated, aiding monetary policy decisions and providing a detailed summary of monetary policy activities and conditions within Afghanistan. Nine bulletins were produced under the Afghanistan Economic Governance Program. For more information, please visit the following site:

- www.centralbank.gov.af/quarterly_bulletins.htm.

➤ *Capacity Building*

Capacity building was another important component of the Macro-Economic Reform Project and included a number of mediums. For instance, there was continual on-the-job training for MPD and *Market Operations Department* staff members. This contained a wide range of subjects, many of them in the aforementioned sections. A highlight was extensive field training on survey and interview techniques, leading to more reliable BoP information.

At the same time, formal training was used to foster a greater understanding of monetary policy topics. This included three sessions of formal workshops for DAB staff members in the fundamentals of macroeconomics and monetary policy management as well as international training at the IMF headquarters in Washington, DC for DAB's BoP team leader. Finally, the following courses were designed in the scope of a well-defined curriculum and administered during the course of the Afghanistan Economic Governance Program:

- Monetary Economics,
- Balance of Payments: Analysis and Data Collection,
- Monetary and Financial Statistics,
- Financial Programming and Policy and
- Monetary Policy in Afghanistan.

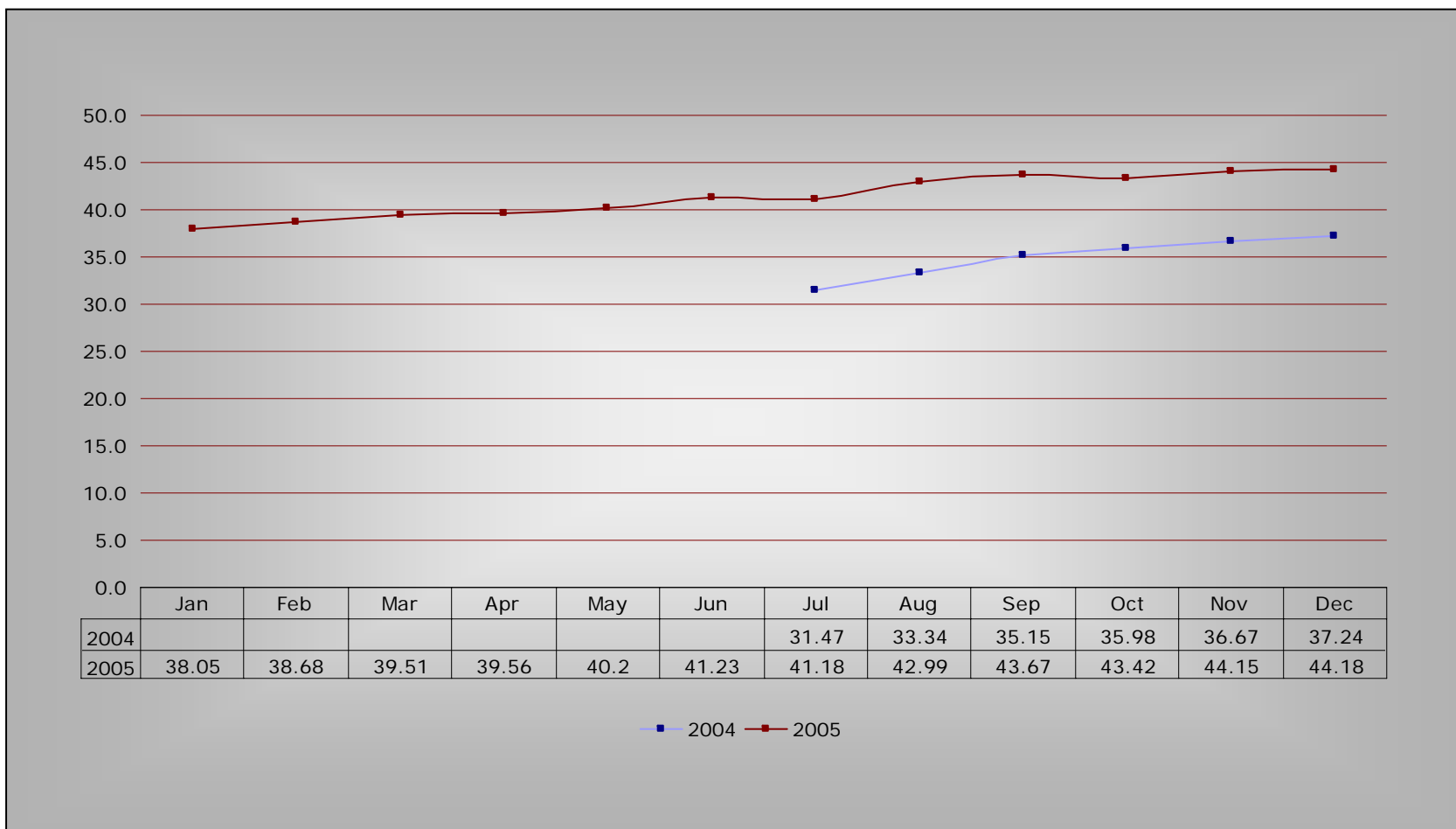
In the interest of preserving intellectual capital and fostering legacy training, the following have been translated from English to Dari and subsequently stored at the DAB *Training Center*:

- Course outlines,
- Reading lists,
- Lecture notes and
- Problem sets.

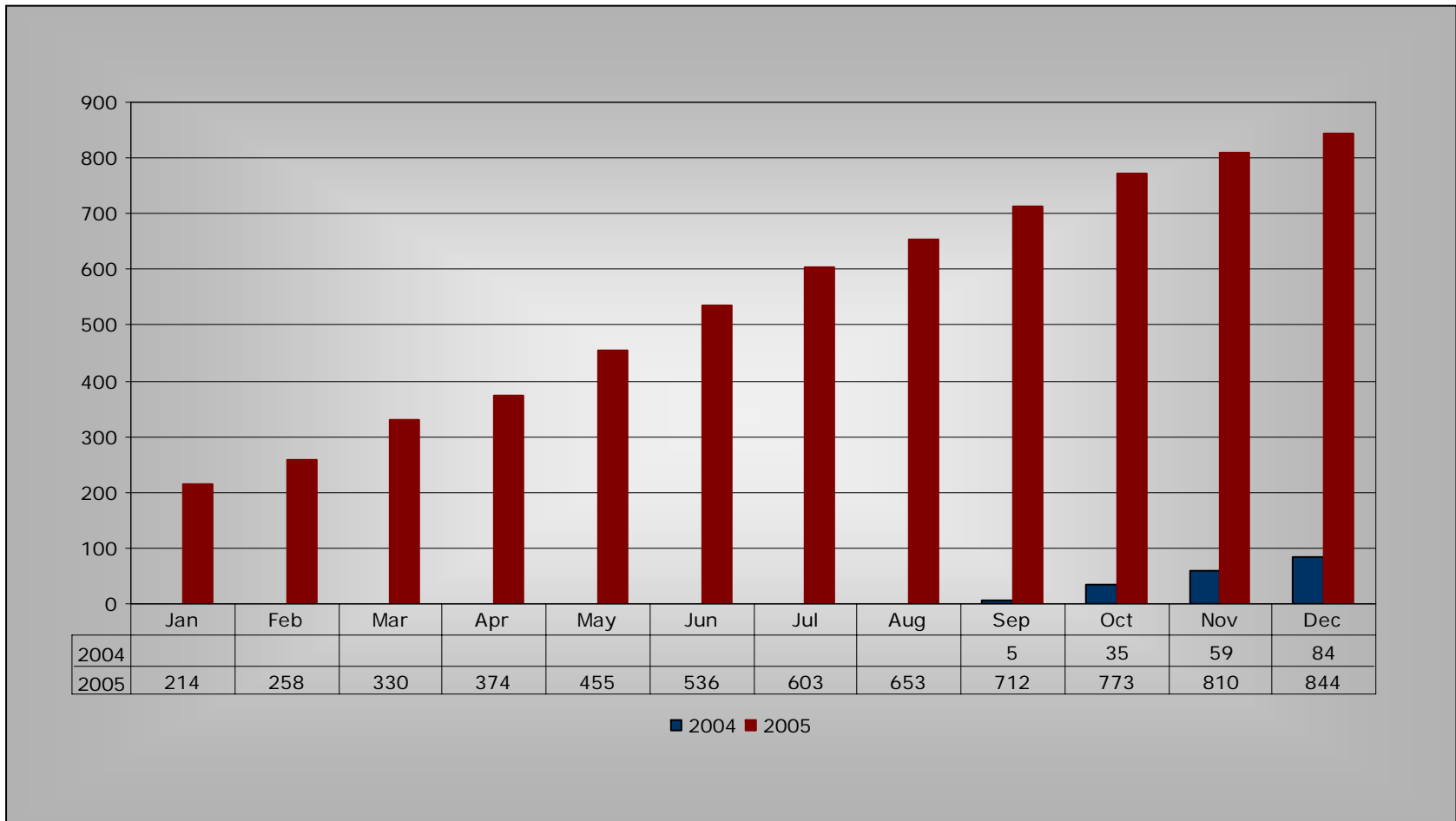
➤ 2004 and 2005 – USD versus Afn Exchange Rate



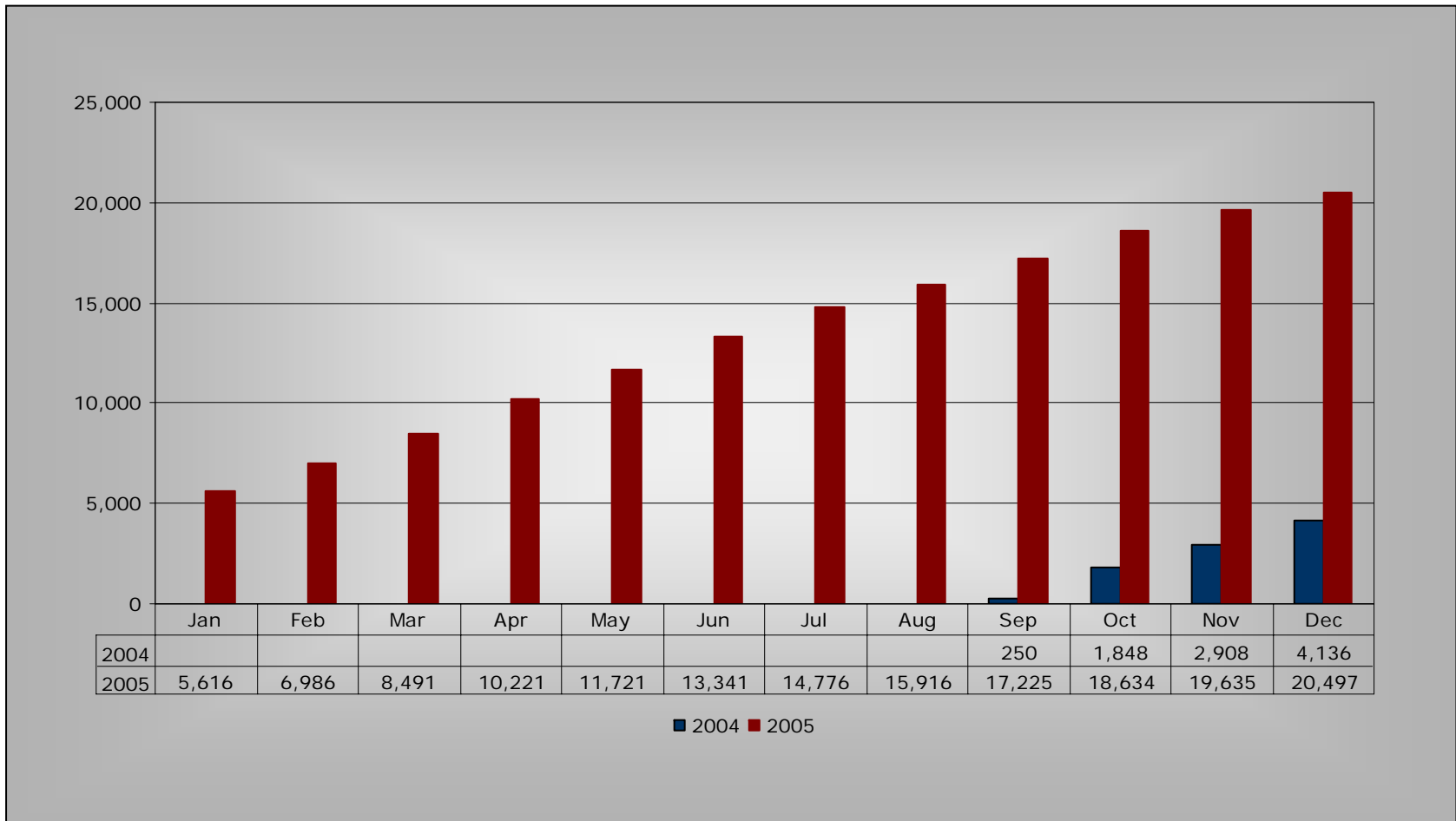
➤ 2004 and 2005 – Money in Circulation – *Afn Billions*



➤ 2004 and 2005 – Capital Notes System – # of Bids



➤ 2004 and 2005 – Capital Notes System Bid Amounts – *Afn Millions*



Reform of Central Bank Operations and Payment Systems

➤ *Before*

When the *Afghanistan Economic Governance Program* began in late 2002, Da Afghanistan Bank (DAB), as the central bank of the nation, had no automated systems for payments or the operational processing of transactions – in its *Head Office* or provincial branches.

- International payments, through SWIFT, were improperly functioning and essentially limited to one correspondent financial institution, with any funds transfer instructions being transmitted by facsimile. Domestic payments between Afghanistan's commercial banks were in cash or done through the use of current accounts, which banks held with each other as well as DAB.
- Payments to the provincial branches were typically sent by mail taking several days and weeks to complete. For the major provincial center branches, payment instructions were sent by telex through the Ministry of Communications, taking several days. Funds transfers to the provincial Mustofiat of the Ministry of Finance for government revenue collection or expenditure disbursements required long-distance travel by Mustofiat representatives to Kabul, taking cash to and from *Head Office* MoF accounts.
- Internal communications with the branches were largely by mail, with accounting reports taking several weeks and months to be received and then consolidated manually. All seventy-four active branches, in Kabul and across the country, reported to the manager in Kabul. In general, management control was minimal, reactive and incidental.
- Transactions were processed and recorded manually. Information to customers, principally the Ministry of Finance, on transaction activity and balances were copied from paper ledger cards by hand. Administration of accounts was by *currency*, not by relationship.

➤ *After*

After less than three years, Da Afghanistan Bank has made giant strides in a) payment distribution systems, b) transaction processing, c) communications as well as d) management structure. These developments, in turn, have enhanced DAB's operability and fostered increases in the use of Afghanistan's *commercial banking sector*.

- International payments, both incoming and outgoing, are now sent electronically via SWIFT, using a network of U.S. and European correspondent banks. The international electronic funds transfer capability has generated increasing use of the formal banking sector instead of cash shipments or moneychangers, *hawalas*. This capability has not only facilitated service to the commercial banks, GoA and development organizations; it has also supported the development of *foreign asset portfolio management* in Market Operations.
 - The introduction of domestic payment systems has supplemented the international capabilities, providing an extension of electronic funds transfer capabilities across the country. Rapid and reliable payment capability between the domestic banks and among the provinces has further supported the growing use of the local currency and the domestic banking system. Inter-bank payments are now made electronically through DAB using its *Afghanistan Clearing and Settlement System* (ACSS), with centralized settlement at DAB. Similarly, payments to the provincial branches (inter-branch) are executed electronically through the *Afghanistan Funds Transfer System* (AFTS), a web-based, secure messaging system permitting the same-day receipt of processed funds. Both of these systems were a) designed and b) implemented by technical advisors and local staff, under the USAID program.
 - This domestic electronic funds payment capacity has enabled DAB to improve the service of payment requirements for the MoF, other ministries, development programs as well as additional major customers, e.g. the U.S. Army, to move funds electronically instead of physically. DAB, through 30 provinces collects payments for about 25,000 Afghans going on Hajj. DAB has provided funding to over 10,000 community projects in 30 provinces under the World Bank-funded National Solidarity Program (NSP). DAB now automatically sweeps revenue funds for the MoF on a daily basis for four major regional centers and weekly, or monthly, for the remaining provinces. Finally, DAB is executing payments to contractor accounts in commercial banks for the MoF and US Army through the ACSS system.
 - Transaction processing within the *Head Office* is now automated, generating account transaction as well as balance information, along with daily reports to the Ministry of Finance. In addition, twenty-five provincial center branches have now implemented an automated accounting program.
 - Organizationally, DAB is now much better aligned. Instead of seventy-four branches reporting on a monthly basis, by mail to the *Head Office*, regional management offices have been established to support provincial branches and ensure timely reporting, via electronic submissions. A Relationship Management Unit at the *Head Office* has also been created to provide customer service to key relationships, e.g. MoF, NSP and the U.S. Army.
-

- Management communication has tremendously improved with the introduction of quarterly workshops, conducted with branch management staff from all provincial center branches. Whereas before there was little formal contact, the branch managers now have periodic sessions with both executive and functional management from the *Head Office* – addressing policy changes, resource issues, new processes as well as training systems for branches. The new DAB e-mail system, implemented in 36 provincial branches, has also enhanced communication channels between *Head Office* personnel and the branches.

➤ *Lessons Learned*

- *Identification and commitment of counterparts* – it is critical at the beginning of the project to clearly identify the counterpart managers working with the advisors and to confirm their roles in the project. Written roles, responsibilities and objectives provide a basis for communication and the periodic review of progress. A firm commitment and definition of roles, responsibilities and objectives would include the executive management as well as the functional counterpart managers working with the assigned advisors
- *Time for decision-making and implementation* – requires more time in Afghanistan than reasonable estimates might suggest. Care must be taken to reach consensus on reform measures proposed, communicate to all concerned parties, train staff (trainers and functional staff) in necessary actions and skills as well as push the reform forward knowing that delays are bound to occur.
- *Retention and training of key employees* – it is critical that the executive management provide fair performance management, competitive compensation and focused training for employees who execute the major functions of the organization. Exit interviews from valued employees who quit revealed three themes: 1) a perception that ethnic considerations were the primary consideration for advancement; 2) The lack of professionalism and expertise of senior management; and 3) the belief that the “old guard” of the Central Bank would reverse all progress once donor technical assistance ceases.
- *Inter-Ministerial communication* – given the inter-dependencies of certain institutions for effective economic governance (e.g., MoF, DAB, MoC as well as MoE), reform agendas specific to each institution should reflect the impact such reform has on counter-part ministries and government agencies.
- *Reform environment and approach* – being a post-conflict environment, suitable reform plans must be employed to adequately compensate for both a lack of managerial experience and unfamiliarity with modern banking systems.

- *Support of capital improvement programs* – acceptance by DAB executive management is needed for the ongoing maintenance and servicing that is required to support major systems and equipment procurement programs. Our counterparts displayed short-sightedness in this area. For example, USAID funded the installation of a satellite network for inter-branch communication and for basic internet coverage of the main office. Once the Central Bank assumed all obligations for this cost, it repeatedly failed to pay bills and put the sustainability of basic business operations at risk. Even though these systems are generating \$ millions of revenue per year, with minimal costs in comparison to yields, senior management would not meet their required obligations.

➤ *Obstacles to Progress*

- *Selection of key counterpart positions* – too often, the selection of important functional positions was not based on merit or skills, rather on relationships or expediency. A pool of qualified staff from which to choose from has been largely absent, and this limited resource base makes the *appropriate* selection of counterparts that much more critical.
- *Compensation* – related to the previous point, a real challenge has been the ability to attract and retain qualified, trainable staff.
- *Weak human resource base* – despite wide-ranging functional training, minimal education and employee skill levels limited the program's ability to build an adequate base of trained employees. Ongoing *capacity building* is therefore required.
- *Objective performance management* – nepotism and corruption are serious issues everywhere in the Government of Afghanistan, including DAB. As mentioned under Lessons Learned, decisions on assignments and promotions are often perceived as based on personal rather than professional considerations.
- *National Security* – physical security, as well as safety, was the main development challenge to DAB's provincial modernization efforts.
- *Information Technology* – as highlighted in the *Introduction* section on page 59, there are a number of core areas within DAB, functioning inter-dependently and resulting in a complete *financial management system*. Information Technology – IT – is one of these core functions, and although USAID did not supply adequate funding at the onset of the project, it is now in a position to broaden the aims of the *Bank Modernization Project*, by way of the *Economic Governance and Private Sector Strengthening Program*. This is absolutely necessary, as any central bank is reliant on a reliable and properly functioning Information Technology system.

- *Weak infrastructure* – the poor or non-existent availability of infrastructure resources for DAB – facilities, power, sanitation and water - hindered more rapid development of both the branch network and a more robust, as well as strengthened, National Payment System.

➤ *Guidance for Future Reform*

- Define clear roles and responsibilities for counterpart executives and managers.
- Establish objectives for project assistance actions and timeframes, identified for both counterpart management and project advisors. As part of the planning, resource requirements from the organization should be made clear, in terms of personnel, premises, equipment and executive oversight.
- Ensure that periodic meetings with both *executive* and *functional management* continue. Progress toward objectives, planned action for the coming period as well as issues regarding the commitment of resources should remain agenda items.
- Incorporate counterpart training, both informal and formal, as part of the project objectives for each function. Training should emphasize any skills relevant to the performance requirements of the counterparts, current as well as potential, and should include all core banking functions.
- Employ a change management program from the start of the project. The scope of work within the organization constituted a significant culture change. Having an organization-wide change management effort, involving the executive management of the organization and a developed communications plan would facilitate assistance in the functional areas.
- Ensure a commitment by executive management to the maintenance, servicing and support of major expenditure programs, e.g. IT systems equipment in the *Head Office* as well as across the larger branch network
- Focus on incremental improvements, not “paradigm changes.” The Government of Afghanistan and the Central Bank are not ready or able to make big jumps. While this may sound defeatist, it is in fact realistic. The Afghan financial system will not become modern overnight, but by slow incremental changes.
- Link assistance programs more explicitly to direct commitments for action by the counterparts. Counterpart executive management needs to be a requirement, in order to a) make commitments related to the support of the program and b) be held fully accountable for them.

➤ *Success Stories*

▪ *Payments Systems*

A significant success has been the establishment and maintenance of internet-based, international and domestic electronic payments systems. First, the institution of SWIFT for international funds transfers, coupled with the resurrection of international correspondent banking relations in Market Operations, has provided a reliable payment system, contributing to both aid programs and the rebuilding of Afghanistan's commercial banking system.

The extension of electronic payments capabilities within Afghanistan has similarly been a significant success, particularly the ability to transfer funds to the provincial centers. The Afghanistan Funds Transfer System (AFTS) has enabled DAB to make same-day payments to and from accounts in the provincial branches. Previously, payments were made by post of telegram, through the Ministry of Communications, which involved days or weeks. This capability for expediting funds flows has provided a major benefit to the MoF for the collection and disbursement of government funds, to the National Solidarity Program for the disbursement of community development funds for the provinces and to the Ministry of Hajj for the efficient collection of payments.

▪ *Branch Management*

While still a “work in progress,” the success story concerning branches relates to the successful implementation and the sustained operation of the automated payments systems. The DAB branch network – now and for the foreseeable future – forms the core foundation of the National Payment System. Advisor efforts in this regard, coupled with those in the Payments and Bank Operations area, made possible immediate reform in branch operations, including training that has significantly enhanced payment and funds transfer service capabilities for DAB.

Payments capability has, in turn, facilitated the implementation of high-priority government reforms and programs. The MoF now has in place a consolidated Treasury Single Account (TSA), in accordance with an IMF agreement, that supports more effective governmental financial management through daily and weekly sweeps of revenue from the provincial mustofiats as well as expenditures to the provincial mustofiats. The World Bank-funded National Solidarity Program (NSP), which recently exceeded AFN 7 billion in disbursements to community development programs, uses DAB's AFTS. Use of the provincial DAB branches, coupled with the AFTS system, has dramatically improved collection procedures for the Hajj Payment Program, with over AFN 2 billion – from some 25,000 pilgrims – in collections each year.

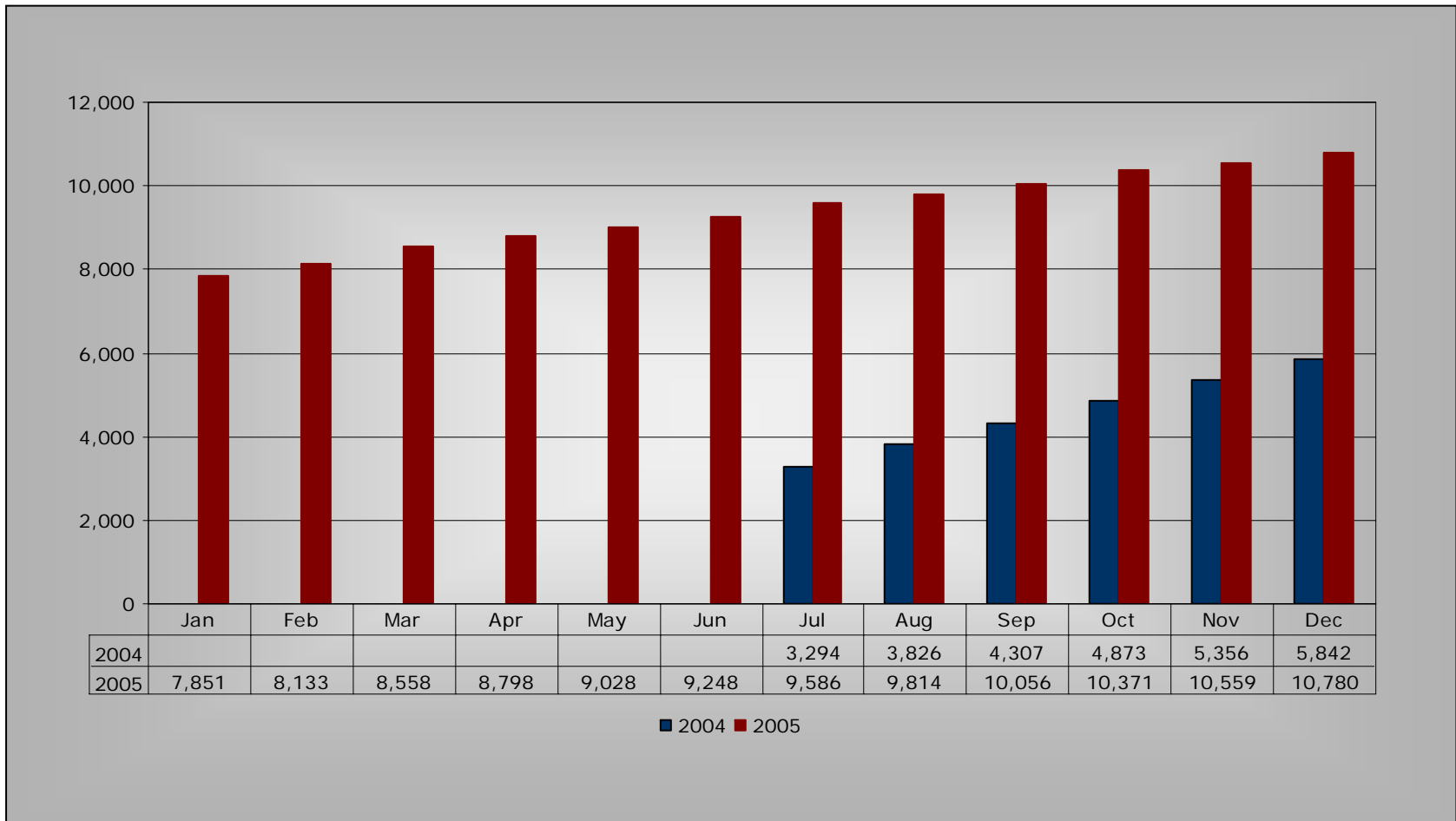
Equally important, these achievements have built a strong foundation for the development of the commercial banking and financial services sector. Having national-reach capabilities in place has allowed commercial banks to use DAB as a pay agent for expanding services to their customers – a move which has increased public interface with the banking sector and exposed citizens to basic banking and payment services. Collectively, the results of the project's technical assistance have laid a critical foundation for the National Payment System (of which DAB provincial branches play a central role), established the pre-conditions for a more rapid evolution of the commercial banking and financial services sector as well as promoted capital movement flows by way of the formal, regulated sector. These facts amount to a genuine success story, given the base from which *banking sector reform* began.

■ *Transaction Processing*

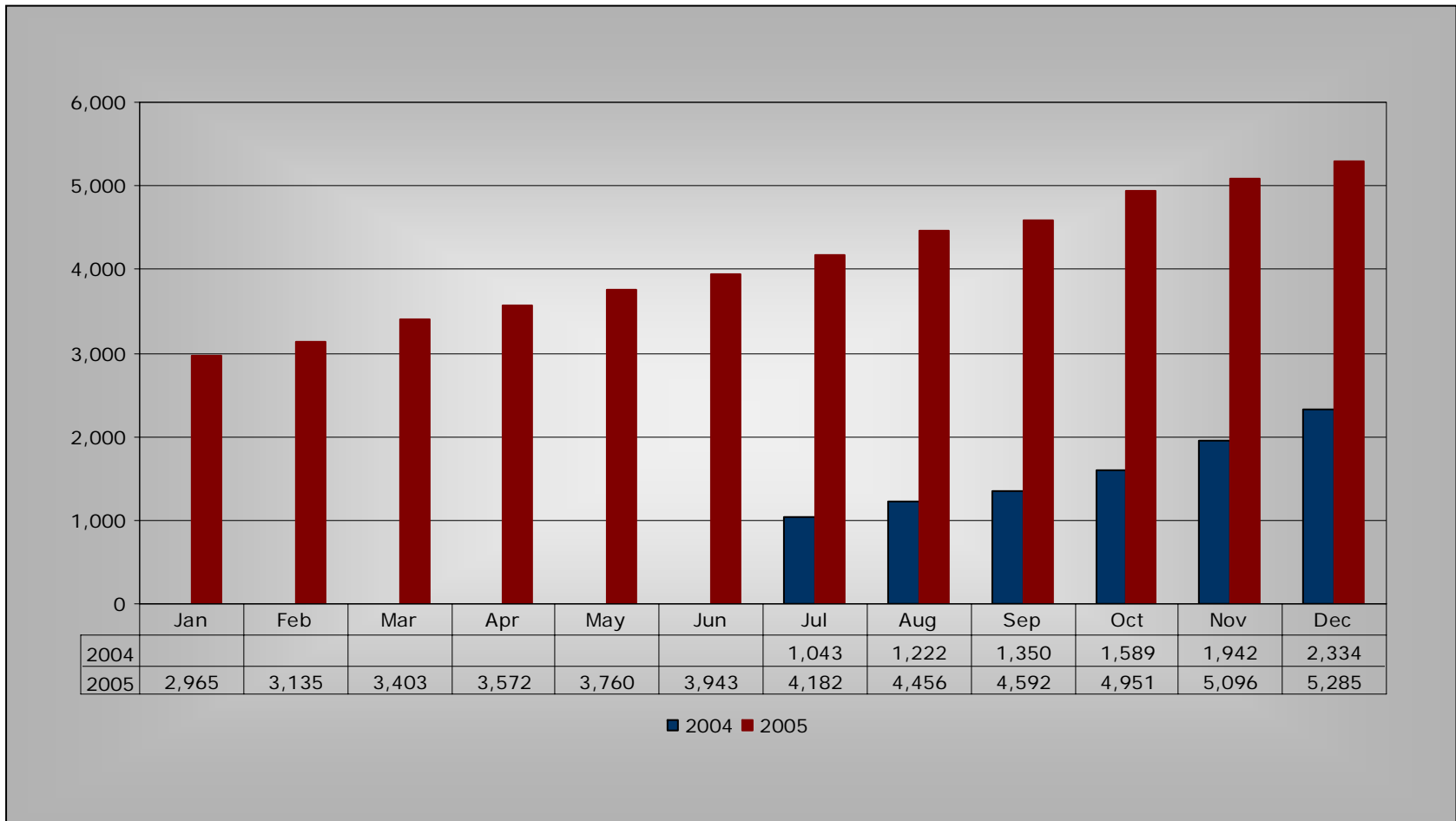
When the project team arrived, all transaction processing was manual, with posting to paper ledger cards. Now, the *Head Office* and major provincial branches use computer applications for the processing and posting of transactions. Processing time has therefore been reduced by an estimated 2/3. Another major improvement has been the ability to provide electronic account statements to the MoF and other key customers, electronically. Finally, accuracy has increasingly been enhanced, with the a) automation of transaction processing, b) the introduction of standardized and simplified forms as well as c) the installation of documented procedures.

In addition to automation and more efficient processes, organizational changes have supported operational improvement. Transaction processing, previously conducted in parallel operational units for local and foreign currency, was consolidated, making more effective use of limited skilled resources. As part of the new organizational structure, a specific unit was established to provide the MoF, key customers, government ministries, commercial banks, U.S. Army as well as NSP personnel with a single point of contact for service and issue resolution. Instead of customers having to contact different units responsible for different transactions, formerly scattered around the Bank, there is now one office serving as the primary customer contact point. While still in the early stages, communication as well as problem resolution has been enhanced for numerous customers.

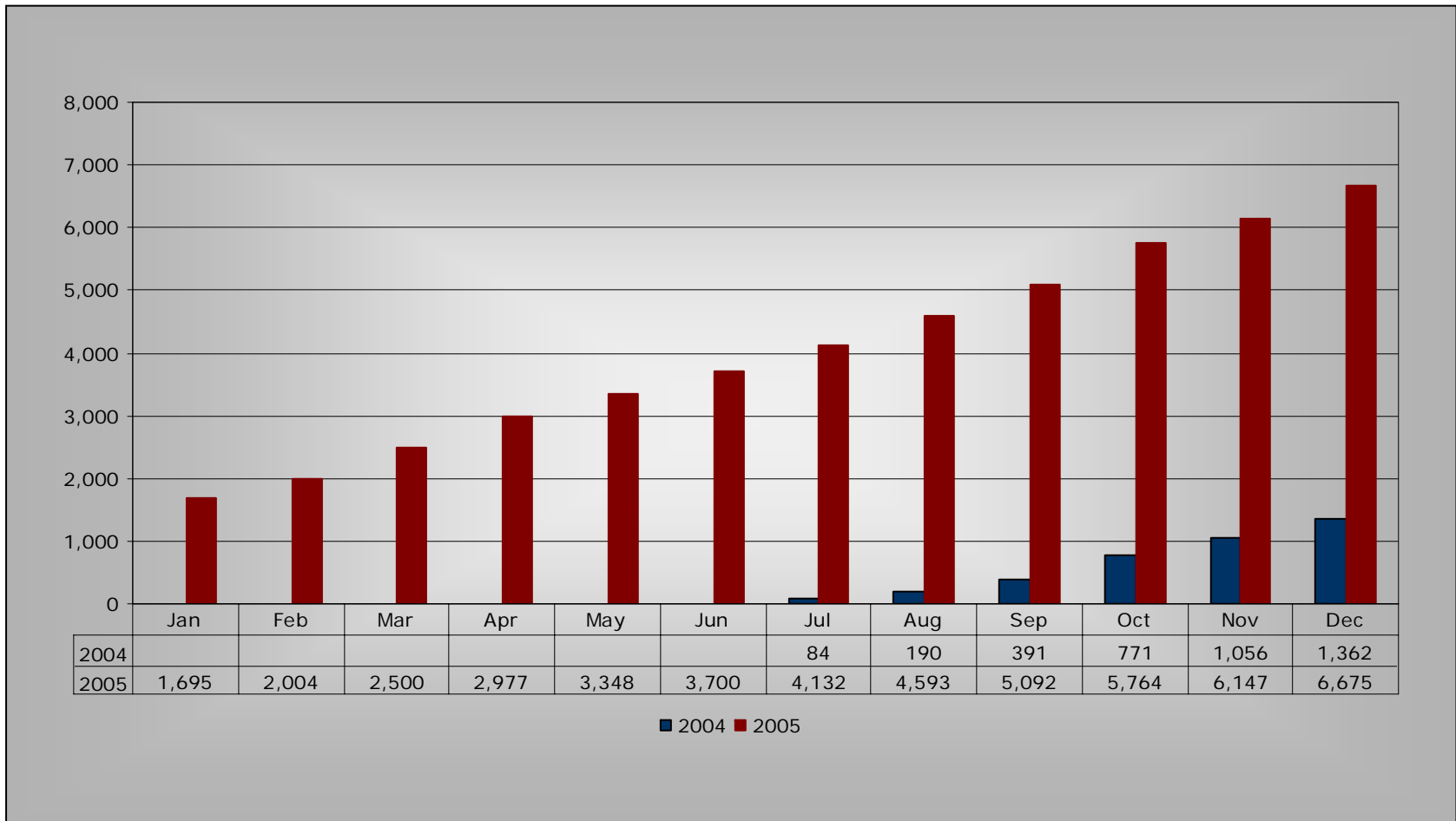
➤ 2004 and 2005 – International Funds Transfer System – # of Transfers



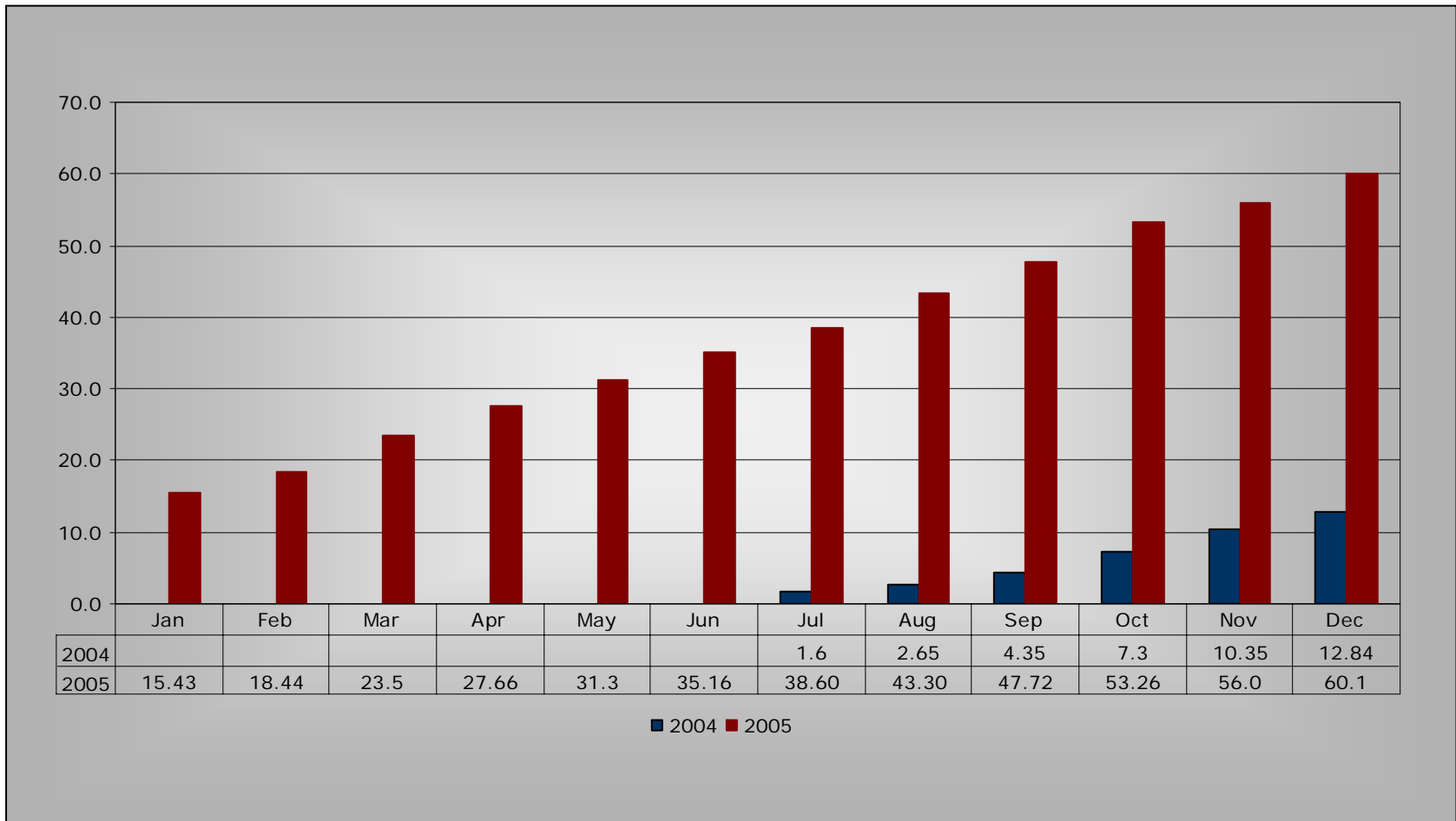
➤ **2004 and 2005 – International Funds Transfer System Amounts – \$ Millions**



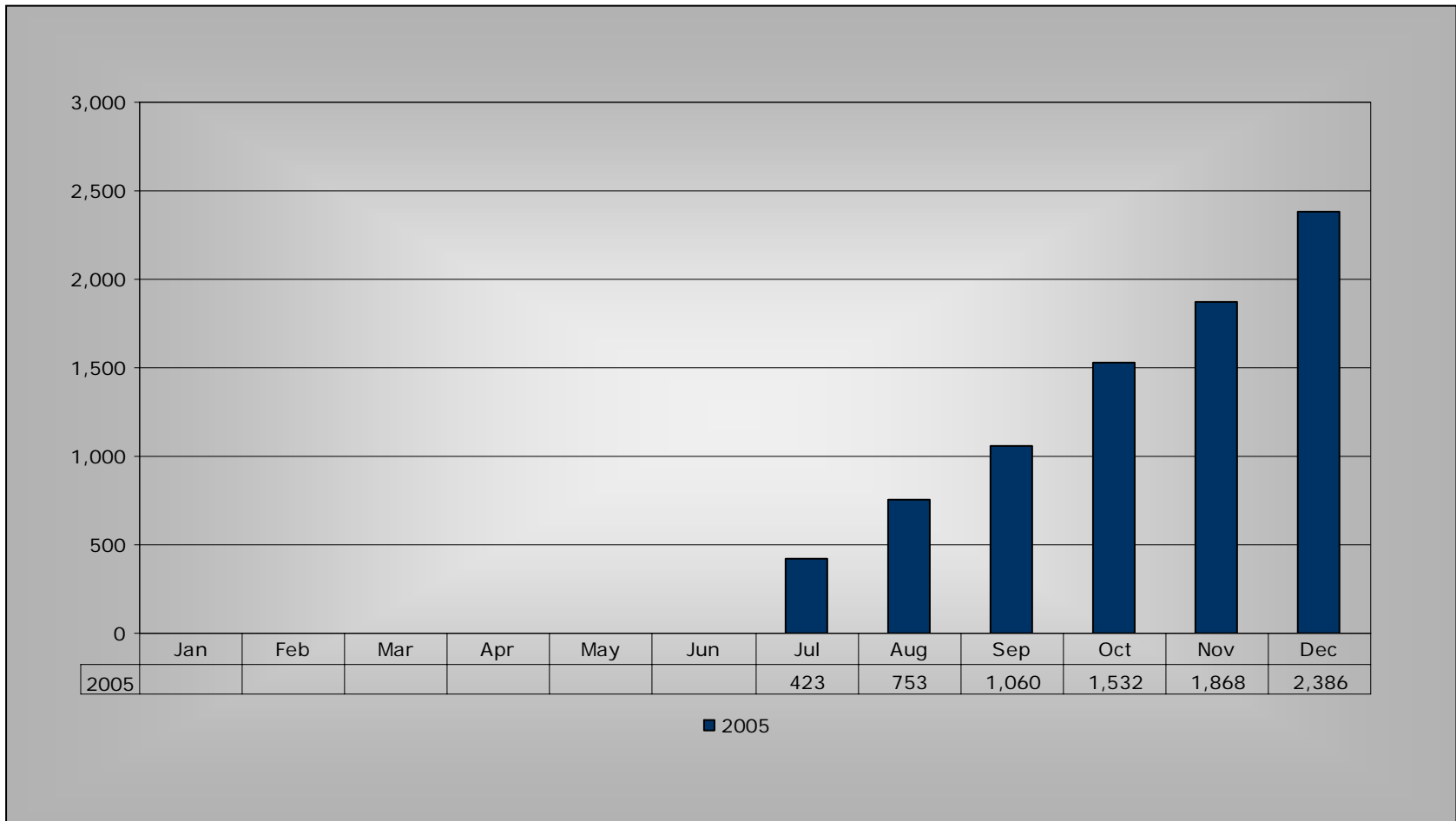
➤ 2004 and 2005 – Afghanistan Funds Transfer System – # of Transfers



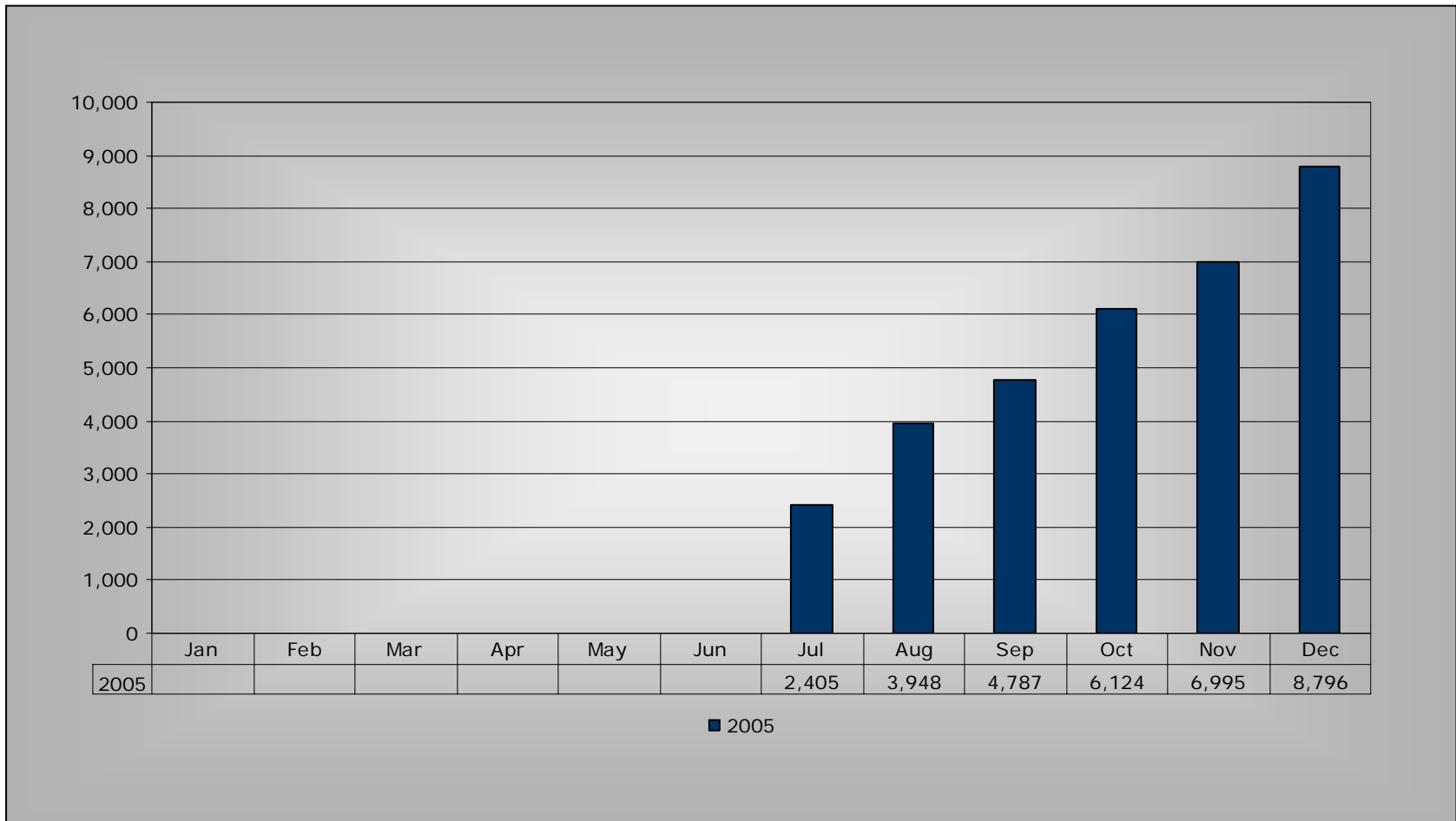
➤ 2004 and 2005 – Afghanistan Funds Transfer System Amounts – *Afn Billions*



➤ **2004 and 2005 – Domestic Inter-Bank Clearing System – # of Transactions**



➤ **2004 and 2005 – Domestic Inter-Bank Clearing System Amounts – *Afn* Millions**



Commercial Banking System Reform

➤ *Background*

At the onset of the *Commercial Banking Reform Project*, Afghanistan included six *state-owned* institutions, along with Afghanistan's Central Bank – *Da Afghanistan Bank* (DAB). Due to years of both political and military conflict, these institutions were mostly inactive. As a result, most banking services were provided by DAB, alongside a very active informal sector.

➤ *Afghanistan's Informal Sector*

Moneychangers and *hawalas* – informal remittance systems commonly found in South East Asia – were two of the main elements in the informal a) financial and b) banking sectors. While not licensed to accept deposits or make loans, they would effect these two business transactions, since there was little to no supervision or monitoring. In fact, any laws that directly or indirectly applied to their activities were either antiquated or largely ineffective.

The *hawalas* were members of an underground activity that efficiently a) gathered deposits, b) made loans and c) effected international transfers. As a result of the Taliban regime, public confidence in the financial sector dwindled, and the majority of Afghans relied on these *hawalas* and moneychangers for almost all banking needs.

➤ *Reform Strategy*

Due to international aid and assistance as well as the migration of numerous NGOs to Afghanistan, traditional banking services increased in demand. Additionally, a number of repatriated Afghan business-people required general banking services and loans. For the majority, requests for business were ignored by the nation's state-owned banks.

DAB assumed the functions of a Central Bank, such as Regulatory Supervision, and consequently made plans to divest itself of all commercial banking services, formerly offered. At the same time, the banking laws were revised and promulgated in 2003, in concert with the IMF. These laws provided for regulatory supervision of the financial sector and designed licensing standards for a) existing and new banks or b) branches of foreign banks. Due to this set of circumstances, two objectives developed:

- Attract new banks or branches of foreign banks into Afghanistan and
- Assess the condition and possibility of re-licensing all state-owned banks.

As noted on the prior page, there was a discrete set of circumstances within Afghanistan, leading to both the aforementioned objectives and the following *road map* for reform. This plan was based on initial assessments, upon entering the country, and guided the majority of tasks under the *Commercial Bank Reform* umbrella.

| Task Name | Status |
|---|--------|
| Develop <i>restructuring strategies</i> for <i>state-owned banks</i> | ✓ |
| Select institutions to be <i>restructured</i> | ✓ |
| Assist <i>selected banks</i> with the submission of <i>license applications</i> | ✓ |
| Develop <i>exit strategies</i> for <i>state-owned banks not restructured</i> | ✓ |
| Develop <i>consolidation strategy</i> | ✓ |
| Revise <i>strategic plans</i> | ✓ |
| Develop <i>transition strategies</i> for <i>non-state-owned banks</i> | ✓ |
| Identify all <i>non-government banking relationships</i> | ✓ |
| Collect all <i>information</i> linked to these relationships | ✓ |
| Develop a <i>transition plan</i> for their services | ✓ |
| Facilitate the <i>implementation</i> of these plans | ✓ |
| Aid in the <i>completion of transfers</i> | ✓ |
| Identify <i>services</i> and <i>customers</i> remaining within DAB | ✓ |

| Task Name | Status |
|---|--------|
| Establish <i>dormancy clauses</i> within the <i>Banking Law</i> | ✓ |
| Aid in the development of <i>Bank Hall</i> services - <i>for special accounts</i> | ✓ |
| Establish a strategy for <i>banking sector development</i> | ✓ |
| Establish <i>Information Sharing Forums</i> | ✓ |
| Facilitate the development of a <i>Bankers Association</i> | ✓ |
| Promote <i>participation</i> in the <i>Bankers Association</i> | ✓ |
| Install new <i>banking institutions</i> | ✓ |
| DAB <i>Bagram Branch</i> | ✓ |
| Identify <i>branch location</i> | ✓ |
| Establish <i>Memorandum of Understanding</i> for DAB and <i>US Military</i> | ✓ |
| <i>Identify</i> and <i>address</i> logistical requirements | ✓ |
| Develop branch <i>infrastructure</i> and <i>staffing</i> | ✓ |

➤ *Bagram Branch Opening Ceremony*

The *Central Bank of Afghanistan* (DAB) held the official opening ceremony of its new branch at the U.S. Army Base in Bagram on August 9, 2004. The branch had been operational since July 19, 2004 and offers the following services:

- *Electronic Fund Transfers* – domestic and international,
- *Foreign Currency Exchange* – between foreign currencies as well as Afn and
- *Distribution of Afghan Currency* – to the Parwan Province.



DAB's former Governor speaking at the opening ceremony.

➤ *Reform Progress*

Following the formal inclusion of the *Afghan Banking Law*, 3 new financial institutions were licensed in September 2003:

- First Microfinance Bank,
- Standard Charter Bank and
- National Bank of Pakistan.

Following these three, six additional banks or branches were granted licenses and include:

- Kabul Bank,
- AIB,
- Alfallah Bank,
- Habib Bank,
- Punjab Bank and
- Aryan Bank.

As noted in prior sections, full assessments of Afghan state-owned-banks were conducted, consequently measuring the feasibility of a) reviving and b) re-licensing them. The institutions were comprised of:

- Bank Millie Afghan,
- Pashtany Bank,
- Export Promotion Bank,
- Industrial Development Bank,
- Agricultural Development Bank and
- Construction and Mortgage Bank.

As a summary, a) Bank Millie, b) Pashtany and c) Export Promotion were re-licensed, while liquidation strategies were designed for the remainder. At the request of *Da Afghanistan Bank*, technical assistance for the re-licensing process of the three remaining was provided. Re-licensing procedures began in December 2003, and the license applications were formally submitted to DAB, as needed by law, in March of the following year. With a number of conditions being assigned, all 3 licenses were issued on time.

At the same time, DAB and the Ministry of Finance agreed to exchange a set of assets. Due to this, the MoF became the majority shareholder of two of the re-licensed institutions, Millie and Pashtany, while ownership of the Export Promotion Bank remained with the Ministry of Social Affairs. Former Minister of Finance Ghani also elected to assume responsibility for the implementation of numerous re-licensing conditions as well as the renewal of both Millie and Pashtany. At that point, the Afghanistan Economic Governance Program's tasks ceased.

As a direct result of these various reform measures, Afghanistan has a number of new institutions, now serving its numerous market segments and providing modern banking services – such as Automated Teller Machines, to the general public. Additionally, 3 Afghan institutions were successfully re-licensed, thereby affording them a chance to modernize and compete with brand new institutions. This was the preferred alternative to a complete elimination of the local banks.

Progress has been made, and these reforms are indicators of the Commercial Banking Project's initial success. In order to sustain this progress, however, the state-owned-banks need additional assistance to modernize and meet all of their re-licensing conditions. Since their *market share* is large and they continue to be traditional banks within the nation, it will be necessary to promote performance in a rapidly developing system.

➤ *Transfer and Charge-off Project*

DAB staff members, with ongoing guidance from technical advisors, administered the *Transfer and Charge-off Project*, which was tasked with a) charging-off small accounts (less than 25 Afn), b) transferring both DAB current and savings accounts to Afghan commercial banks and c) transferring dormant accounts (over 25 Afn) to a special safekeeping account.

Project status reports and regular meetings with senior staff members offered timely progress data, thereby aiding management decisions in the following areas: 1) account recording, 2) data timing, 3) efficiency of operation and 4) account transfer. Finally, all active account information was entered into one database, facilitating the verification process and securing manually generated information into one system.

Under the *Central Bank Law*, as well as pursuant to action by the *DAB Supreme Council*, it was compulsory to transfer commercial banking activity within DAB to the commercial banking sector. This called for a large media campaign and required coordination among DAB client groups and various banks. On the following page, you will see an aggregate table of project transfer totals as well as a photo of licensed banks inside DAB, where account desks were placed to promote services, justify costs and encourage depositors to choose their commercial bank.

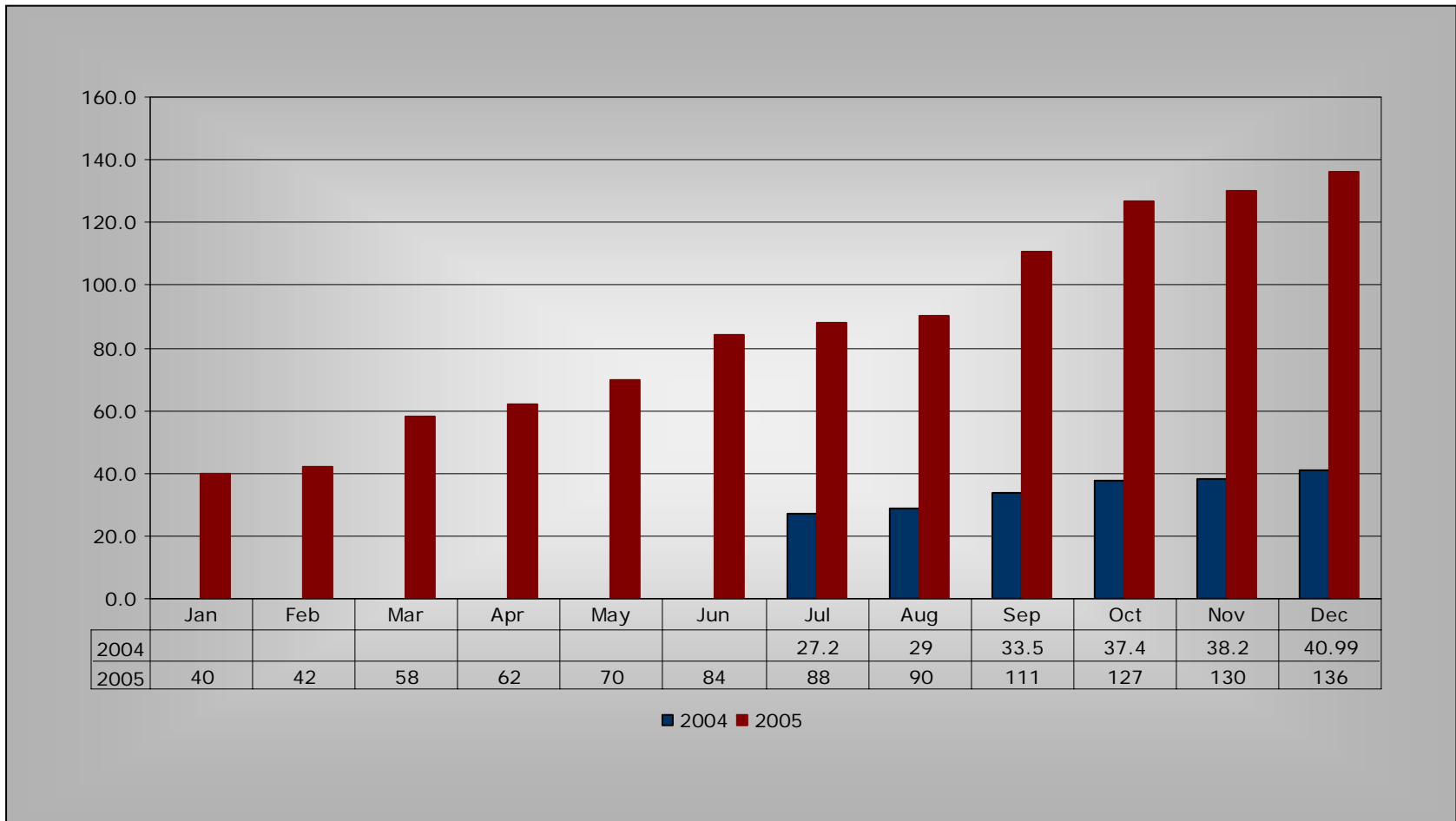


| <i>Transfer and Charge-off Project – Summary Totals</i> | | | | |
|---|--|-------------|--------------------|------------|
| | Closed by customer or transferred to either a commercial bank or DAB's Control Account | | Transferred to DAB | |
| | Active Accounts | Afn Totals | Dormant Accounts | Afn Totals |
| DAB HQ | 2,194 | 550,000,000 | 20,532 | 11,701,144 |
| DAB City Branches | 201 | 283,556 | 653 | 945,200 |
| DAB Provinces | * * | * * | 2,790 | 3,359,208 |
| Local HQ | - - | - - | 66,150 | 36,517,554 |
| Local City Branches | - - | - - | 5,384 | 1,380,768 |
| Local Provincial Branches | - - | - - | 5,665 | 1,795,927 |

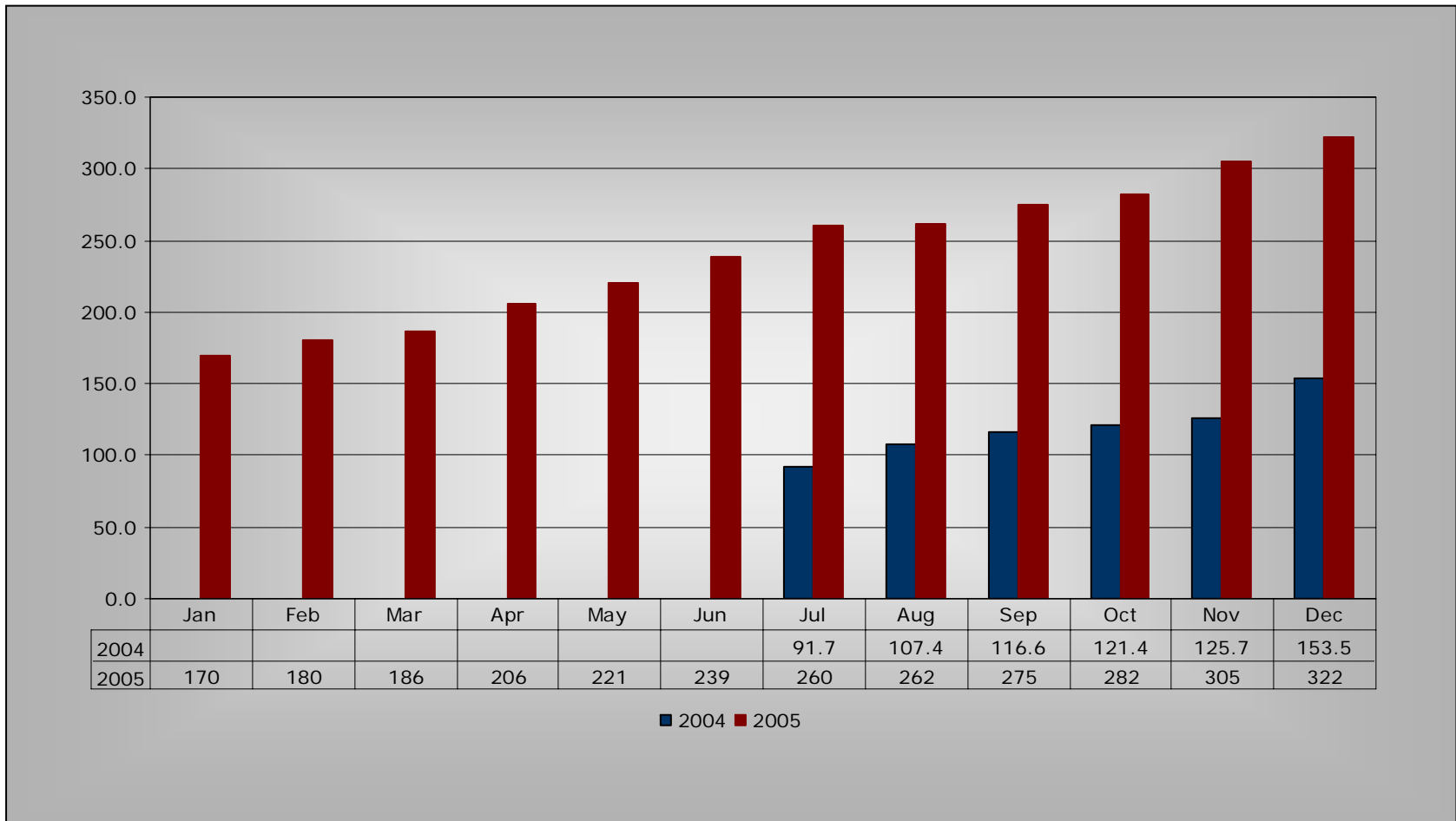
* * Information not available.

- - Local banks only required to transfer dormant accounts to DAB HQ.

➤ 2004 and 2005 – Issued Loan Amounts – \$ Millions



➤ 2004 and 2005 – Deposit Growth – \$ Millions



Prudential and Regulatory Reform

Before September 2003, there had been initial developments in the Financial Supervision Department (FSD), which was a new department established by DAB in August 2002. Newly-hired examiners received training in English, IT and basic concepts of bank supervision, focusing on anticipated licensing activity. Project advisors, in cooperation with advisors from the U.K. Department for International Development and the International Monetary Fund, assisted DAB in drafting and sending for approval by Afghanistan's Cabinet the *Law on Da Afghanistan Bank* (also known as the Central Bank Law or DAB Law) and the *Law on Banking in Afghanistan* (Banking Law).

The two laws were enacted by Presidential decree on September 16, 2003. That set the stage for twenty-six months of significant, advisor-assisted accomplishments. A summary of this reform, beginning on page ninety-seven, has been organized according to the *five* functional sections of the FSD:

- Licensing and Corporate Activities,
- Accounting, Reporting and Commercial Bank Audit,
- General Supervision: *off-site* and *on-site*,
- Special Supervision and
- Legal and Regulatory.

The following is an introductory section describing a) restructuring, b) training and c) cross-cutting efforts for the FSD.

➤ *Restructuring*

The FSD was reorganized in 2004, with the assistance of project advisors. "Caseloads" of banking organizations were created, headed by caseload managers who began the task of coordinating all of the supervisory activities directed toward their portfolio of financial institutions. New civil service procedures were used in placing some existing staff in senior management positions and hiring new examiners. Women are well represented in the FSD. In fact, three of the original seven members of the senior management team were women, and the majority of the newly-hired examiners are also women.

The senior management team was subsequently expanded in 2005 to 13, with the integration of six highly-trained former BearingPoint employees onto the DAB staff as specialists. Total FSD allocated staff positions are 40, and 35 positions have been staffed. All staff members have received significant classroom, as well as on-the-job training, in many aspects of the supervisory process.

➤ *Training*

Formal classroom training has taken place almost continuously, since the beginning of the program in 2003. Advisors adopted the approach that *cross-training* (training all or most of the staff in the concepts and methods of on-site examination and off-site monitoring) was desirable, since those two activities are the cornerstone of the supervisory process, and a basic understanding is essential even for those working in Licensing, Legal and Regulatory or other sections.

Accordingly, FSD staff – both inside and outside of General Supervision – attended the series of training courses, which included Introduction to Examinations, Financial Institution Analysis, Basic Loan Analysis, Letters of Credit, Accounting and Reporting Requirements as well as the Legal and Regulatory Framework. Due to the importance of foreign branches within the banking system, extensive training was provided on the differences of supervising a foreign branch versus supervising a full-fledged bank.

In cooperation with the IMF advisor to DAB's Training Center, project advisors developed a plan for the further training of FSD staff, through the year 2007, including brief course descriptions and lists of recommended participants. Some of the courses will be taught by project advisors, and others will be taught by outside parties invited by the Training Center.

In addition, project advisors assisted in identifying suitable training opportunities in the United States and other countries for the senior management team of the FSD, funded from various non-project sources. So far, seven members of the senior management team have received training in the United States, and one attended a workshop in Singapore.

➤ *Cross-cutting Initiatives*

There were three major cross-cutting initiatives spearheaded by project advisors in the FSD: periodic senior management meetings of the FSD, quarterly meetings between the FSD and commercial bank management and the introduction of *Supervisory Circulars* and *Accounting Circulars* to give instructions to the commercial banks and keep them informed of developments.

In the first initiative, the advisors showed the General Director of the FSD how to hold a senior staff meeting and how to solicit input from his team. Two of the sessions were devoted to the Basle Core Principles of Effective Banking Supervision, and the advisors explained the principles and discussed a timetable of gradual compliance.

In the second initiative, quarterly meetings were held with the CEOs of banks and general managers of branches of foreign banks. The First Deputy Governor participated in these numerous meetings, which were useful to discuss a) trends and potential problems, b) future plans for development of the banks and c) compliance with Afghan laws and regulations.

In the third initiative, more than 30 *Supervisory Circulars* and *Accounting Circulars* were issued to banking organizations. They covered topics such as compliance with the reserve requirements, accrual of taxes, supervisory issues involving foreign branches, transfer of dormant accounts as well as compliance with financial reporting deadlines. The circulars were a very effective mode of communication with the regulated institutions and will ultimately be placed on DAB's website as public documents.

➤ *Licensing and Corporate Activities*

The passage of the laws gave DAB the go-ahead to issue four new bank licenses, three re-licensings of previously-existing state-owned banks and five permits to branches of foreign banks. The new banks and branches were the first new banking organizations to appear in Afghanistan in more than 30 years. Before this could be accomplished, however, project advisors assisted DAB in developing rules, procedures as well as an application package so that the many interested applicants knew what was expected of them. These procedures were fully consistent with international standards and included interviews of *potential directors* and *management*. On the basis of these interviews, DAB rejected some of the nominees, and the applicants consequently supplied new candidates for consideration.

In addition to the twelve newly-licensed and permitted banking organizations, DAB licensed one *money service provider* (combination foreign-exchange dealer and money transfer service) and more than one hundred *foreign exchange dealers*, all under new procedures and tougher standards developed by direction of the Afghanistan Economic Governance Program.

The licensing of foreign exchange dealers was DAB's first step towards bringing the alternative remittance system (also known as *hawala*) into the formal sector. This major effort lasted many months, as the *hawaladers* were accustomed to operating in a totally unregulated environment and at the undisputed center of Afghanistan's financial system. At the same time, the licensing process resulted in a large number of *Taxpayer Identification Numbers* issued to this group, which exemplified cooperation between the Ministry of Finance and DAB. The next step, which will occur in both 2006 and 2007, is the upgrade of *hawala* licenses into *money service provider* licenses and the formal introduction of reporting requirements.

Advisors also helped the Licensing and Corporate Activities section develop a standard schedule of application fees, not only for the establishment of new institutions and branches, but also for permissions to engage in various activities for which advance approval is required under the Banking Law.

During 2005, the banking sector began to expand through the establishment of branches in the more populous provinces (with strong business activity) – the total number of branches opened was 13. Although Afghanistan experienced an increased level of insurgency during the year, potential bank organizers continued to express an interest in obtaining a bank license, and these are currently in the process of evaluation.

In addition to the licensing activity, the section is directly responsible for evaluating proposed management and board of supervisor members. Advisors have assisted the section in evaluating CVs and interviewing candidates. Subsequent to the interviews, the section was guided through the decision-making process, with a final recommendation for approval or denial of a candidate. In addition to these position decisions, *licensing evaluates* proposed external auditors and recommended approval or rejection to Senior Management.

Numerous small audit and accounting firms are entering the Afghan market, and these firms are offering services at a more than reasonable price, in order to generate business within the market. The Licensing Section is well aware of this fact and the advisor has assisted personnel in focusing upon the professional experience and expertise of the firms. A primary consideration for approval is whether the audit firm has had appropriate experience auditing financial institutions and whether the audit firm is guided by seasoned professionals.

➤ *Accounting, Reporting and Commercial Bank Audit*

With major assistance from project advisors, DAB introduced a package of reporting forms and instructions for banking organizations in March 2004. The forms and instructions marked the first application of International Accounting Standards to any type of Afghan organization – public or private – in decades.

The mandatory reporting forms, some monthly and some quarterly, included the balance sheet, balance sheet memorandum items, income statement, income statement memorandum items, trading account composition, investment account composition, reconciliation of reserves, past-due and non-accrual as well as derivatives and off-balance sheet items. Later, the list of mandatory reports for supervision purposes was expanded to include asset classification and loan-loss reserves, a liquidity report as well as a regulatory capital worksheet.

In many transitional countries, a multiplicity of overlapping and duplicative reporting requirements poses an undue burden on banks. To avoid this problem, DAB centralized all bank reporting in the FSD. Accordingly, the section began to collect data on behalf of the Monetary Policy Department. Reporting forms for *inbound and outbound remittances* (useful in Balance of Payments measurement) and *reserve requirements for monetary policy purposes* were developed and implemented. DAB also intervened when the Central Statistical Office attempted to introduce its own incompatible reporting forms for the commercial banks, resulting in a block of this move.

Project advisors also assisted in training DAB staff to edit the financial reports submitted by the banks. Although the process could be made more efficient, many errors were caught and explained to the banks, resulting in more accurate submissions as time went on. The resulting database of financial information on the banking sector had many uses. First of all, it enabled DAB General Supervision examiners to keep watch on the condition and performance of individual banks. Next, it enabled aggregate statistics to be compiled on banking sector activity, which had not been done for 30 years – this data was used extensively by the Governor and Deputy Governors in briefings. Finally, it enabled the IMF Monetary Survey to be prepared, assisting both DAB and the IMF in formulating and carrying out monetary policy.

Less progress than initially planned was made on enforcing the mandatory annual external audit of all banking organizations. DAB had planned, with advisor assistance, to establish standards for a) approval of external auditors, b) required scope of external audit as well as c) form and content of audit-related reports and audited financial statements. However, there was insufficient staff at DAB to handle this task (the section's staffing was increased only in 2006), coupled with insufficient time for the advisors to focus on this important matter.

Nevertheless, most of the banking organizations did engage the required external audit, and there were discussions between the audit firms of two banks and DAB representatives on the scope and scale of the audits. Finally, DAB rejected more than one *auditing firm*, in light of minimal audit knowledge.

➤ *General Supervision*

▪ *Off-site Monitoring*

Considerable progress was made by DAB in developing the off-site supervision function. There were two main areas of accomplishment: “macro” monitoring (collecting information and analyzing trends in the banking sector as a whole) and “micro” monitoring (off-site monitoring of the condition and performance of *individual banks*).

In the area of “macro” monitoring, DAB staff, assisted by the advisors, developed a quarterly written analysis of banking sector activity, with attached graphs and tables. The analysis, which has been produced since June 2005, is distributed to the senior management of DAB and is included in the briefings received by the Monetary Policy Committee. In fact, the format and content of the report received praise from an IMF advisor to the Monetary Policy Committee.

“Micro” monitoring also progressed during the same period. The examiners received extensive training in the analysis of *bank profitability* – using both trend analysis and peer group analysis – and wrote analyses of the profitability of each bank, which were then submitted to DAB senior management. To gain confidence in speaking, they also made oral presentations on individual bank profitability to the larger group of examiners, using computerized displays of data. The advisor also trained the DAB examiners in analyzing a) capital adequacy, b) asset quality as well as c) liquidity from off-site, using actual data from the banks as examples, and prepared a template for the examiners to use in writing their own quarterly analyses.

■ *On-site Examination*

Much of the work associated with supervision, prior to 2005, was aimed at organizing the FSD, ensuring the development of laws and regulations, establishing initial reporting requirements for banks and initiating the quarterly review process. On-site work was limited to the inventory of assets at the six state-owned banks, and the information generated in these reviews was utilized to re-license three of those banks. Aside from this, on-site examination work had generally not proceeded. Upon the arrival of the on-site advisor, it was determined that key courses would need to be taught, prior to beginning on-site work. Considerable time was therefore spent with all of the general supervision supervisors, with classroom instruction on *Basic Bank Supervision* and *Intermediate Credit*.

During 2005, in addition to the aforementioned instruction, an on-site examination manual was developed. It contains a section addressing each asset and liability category and focuses on ensuring that all areas of review, necessary to rank the quality of the institution, are included. The manual includes the following subjects:

- Introductory Material,
- Examination Objectives,
- Examination Procedures,
- Internal Control Questionnaires and
- Verification Procedures – if applicable or needed.

In an effort to make the manual as comprehensive as possible, it also contains a *Report of Examination* format, a CAMEL policy as well as numerous pro-forma work papers (utilized during an examination). It also includes a detailed section, delineating work paper documentation requirements and standards. Only a limited amount of this material has been translated to date and includes the following:

- *Report of Examination* format,
- Pro-forma work papers,
- Automated loan line slips and
- A CAMEL policy.

The CAMEL policy has been provided to management for their consideration; however, no actions have been taken or requested of DAB senior management. Instead, given the examinations to be conducted during 2006, the use of the policy will be tested, revised and then submitted to DAB senior management for final consideration and approval. This is the same methodology, which will be utilized for the approval of the *on-site manual* as well as the *report of examination*.

Quarterly reviews of institutions continued throughout 2005. The on-site advisor provided assistance and guidance in this area and recommended that information be requested from certain banks and utilized in the quarterly review. One of the institutions submitted information, which immediately raised concerns as well as the need to conduct a targeted review of loans. With the completion of the credit course, this became the first on-site instance in 2005.

Although the supervisors were not ready to assume complete responsibility for the examination, a team accompanied the advisor to the bank and participated in a complete review of loan files, credit policies as well as all accounting records linked to the loans. Other than risk classification, all issues concerning credits were methodically addressed, with the team receiving comprehensive instruction as well as guidance during the entire process.

During 2005, DAB found it necessary to order the removal of management from an institution. Given the risks associated with this action, the advisor and a team of supervisors immediately entered the institution and began a comprehensive examination. Much of the work performed in the institution would be considered on-the-job training. The review included an assessment of capital, asset quality (including credit risk), management, earnings as well as liquidity – with emphasis placed on any conditions established at the time of re-licensing.

Although theoretically prepared for the work, the staff members were not prepared for its practical application. This shortfall in skills can only be eliminated through continuous presence in on-site bank examinations. Recognizing this fact, 2006 will be a year in which all the institutions will be examined. To facilitate this, an examination scheduling policy was initially drafted, with an accompanying schedule subsequently developed, according to the criteria set within the policy.

The schedule established beginning and ending dates for full-scope examinations, targeted reviews, pre-opening visits and quarterly reviews. Given that this was an initial effort at projecting job tasks, problems will likely surface in meeting the projections. Nevertheless, it is a good first effort, and over time, projections should be met or expectations will be exceeded. It is anticipated that on-going training will fully complement the on-site supervision efforts.

A format has been developed for the recording of supervisory strategies for all institutions, and all personnel have been instructed in its use. The format includes a) background information on the bank, b) the current condition of the institution and c) a final section describing the type of supervisory actions that will occur during the supervisory cycle (as defined by the scheduling policy). It will set dates for examination work and specify the scope of work to be done, along with the personnel necessary to complete the job.

Upon implementation, it became clear that the staff had difficulty in completing this, due to their lack of experience. Therefore, beginning with the 2006 examinations, the EIC will complete a new supervisory strategy at the conclusion of each examination. The EIC will know the condition of the institution as well as the supervisory recommendations. This knowledge, along with the examination scheduling policy, will allow the EIC to formulate a meaningful strategy.

Upon completion, the scheduling information from the strategy will be added to the examination scheduling spreadsheet. This will ensure that at the end of each year, the supervisors have a schedule that, with minor revisions, will be ready to control the examination workflow for the following year. The schedule will also be a reflection of the risks associated with each institution. The schedule for 2006 was developed only with the benefit of off-site observations, which may or may not reflect the risks for each institution.

In addition to the above, a new format has been developed for the quarterly reviews. Personnel are now required to develop a quarterly report analyzing numerous ratios and drafting conclusions on capital, asset quality, earnings and liquidity. Component ratings are to be assigned for each of these elements, with a final composite rating. This approach was utilized for the final quarter of 2005.

➤ *Special Supervision Section*

This section handles problems that arise in commercial banks. Any violations of laws, regulations, or best banking practices necessitate DAB intervention in the form of enforcement actions (written warnings, supervisory agreements, cease-and-desist orders, etc.). Assisted by the advisor, the section was active from the moment the laws were passed. The first enforcement action was the removal of the CEO of one of the state-owned banks (now defunct). On the basis of findings from the inventory examinations already described, the Governor dismissed the CEO for misconduct.

Next, the section became actively involved in the supervision of the re-licensed state-owned banks. All three banks were re-licensed under a stringent set of conditions that placed restrictions on their activities and required various corrective actions. The section monitored compliance with these conditions, and in mid-2005 reported to the Governor on the results. This led to a tailored set of enforcement actions, focusing on the management of these banks.

Section staff met frequently with the shareholders of these re-licensed banks, to discuss their fulfillment of the conditions and the responsibilities of the shareholders. In some instances, though, the shareholders did not encourage the banks to take the necessary corrective actions and even prevented them from doing so.

Additionally, the section issued a successful action against an undercapitalized bank, another successful action against a bank that was not cooperating in transferring its dormant accounts to DAB and another action against a former bank that was stalling in transferring out its remaining, small amount of deposits. The advisor assisted in the preparation of all enforcement actions.

Due to numerous time constraints imposed by the frequent issuance of actual enforcement actions, it was not possible for DAB to complete its manual of a) enforcement tools, b) policies and c) procedures. As a result, this activity has been delayed to 2006.

➤ *Legal and Regulatory Section*

This section is responsible for drafting supervision-related regulations, based on the *Da Afghanistan Bank Law* and general *Banking Law*, reviewing licensing, permitting applications for compliance with laws, regulations as well as policies and contributing supervision-related sections to pieces of draft legislation. Assisted by project advisors, the section was extremely active throughout the 26-month period, due to the passage of the aforementioned laws.

The list of regulations drafted by the section, with advisor assistance, is impressive: *Licensing, Corporate Governance, Change in Control, Capital, Large Exposures Limitations, Asset Classification and Loan Loss Reserves, Liquidity Management and Measurement, Open Foreign Exchange Positions, Permitted and Prohibited Activities, Enforcement, Anti-Money Laundering Responsibilities of Financial Institutions, Licensing of Foreign Exchange Dealers, Licensing of Money Service Providers* as well as *Reserve Requirements for Monetary Policy Purposes*.

Generally, the Supreme Council of DAB passed the regulations exactly as they were drafted by the section, bringing them immediately into effect. Accordingly, DAB now has almost all of the basic regulations it needs to regulate banks and other financial institutions effectively.

The section also introduced to Afghanistan – for the first time in history – a public comment period on draft regulations. Interested parties – most importantly, banking organizations – are given 30 days to comment on a draft regulation before it is submitted to the Supreme Council for consideration. In general, DAB was disappointed in the poor quality of the comments received from the Afghanistan Bankers' Association and from individual banks, but the process itself is still valuable, since it puts banks on notice, at least 60 days in advance, that regulations are to be introduced.

In cooperation with the Afghanistan Bankers' Association, the section also organized a workshop on the entire regulatory framework, which covered key aspects of all regulations and gave the banks an understanding of where DAB is headed in continuing to develop the framework. Additionally, the section contributed to the drafting of a major package of amendments to the DAB Law and Banking Law. The usual practice in transitional countries is that the basic banking laws are in place for about two years before it becomes necessary to amend them, in light of practical experience, and Afghanistan is no exception. Again, the Supreme Council passed the package of amendments without question, and in 2006 they will be presented to the *Afghan Parliament* for enactment.

Finally, working together with the Ministry of Finance and the Ministry of Rehabilitation and Rural Development, the section drafted and sent out for public comment an extensive proposed regulation for the licensing, supervision and regulation of *Depository Micro-finance Institutions* (DMFIs). This proposed rule would bring DMFIs, which are developing rather rapidly in Afghanistan, squarely under DAB's regulatory oversight, not only protecting depositors but also ensuring the orderly development of the micro-finance sector itself.

Human Resource Reform and Capacity Building

➤ *Functional Restructuring*

Human resource reform within Afghanistan's *Central Bank* was a priority from the onset of the Economic Governance Program. As a result, the DAB Human Resource Staffing Section was redesigned and staffed, in accordance with the Priority Reform and Restructuring (PRR) Program. In addition, a Human Resource Policy Section was established, staffed and tasked with building sound human resource policy. It created the following:

- Code of Conduct,
- Performance Planning, Evaluation and Improvement Policy,
- Security Responsibility Policy and
- Training and Development Policy.

At the same time, a) Management and Staff Development, b) Training Center and c) Personnel Administration sections were established or redesigned to aid in the reform process. In fact, the Personnel Administration section showed considerable progress in transitioning from antiquated processes to modern systems. To promote the ongoing analysis of human resource functions and instill self-reliance, a Human Resource Committee was also formed, comprising the DAB Governor, First and Second Deputy Governors as well as a Deputy Controller General from the Internal Audit Department.

As a major element of the reform process, *Da Afghanistan Bank* – DAB – was initially examined and subsequently restructured, in accordance with International Monetary Fund guidelines. The headquarters, the primary and most complex piece, was reorganized in agreement with the IMF, and regional branch reform was initiated by establishing regional offices and assigning regional managers. Under Dr. Ahady, former DAB Governor, the initial restructuring plan was designed and endorsed. Under the new leadership, headed by Governor Delawari, the plan was adjusted to meet new needs and was again endorsed by the Executive Board.

According to the plan, staffing for and movement of functional responsibilities to any of DAB's departments was immediately initiated. Both short and medium-term progress was achieved; however, long-term goals rest on a pending decision, by the GOA, to allow a reduction in both a) staff and b) units. By reducing both staff members and the number of units within DAB, a full transition is possible, and DAB Head Management is ready to effect this change when the political climate becomes favorable. In the mean time, DAB needs to monitor any changing needs to ensure that its structure has the ability to fully include them.

➤ *Staff Restructuring*

As an element of the *Human Resource Reform Project*, job descriptions and discrete roles were designed and documented. The first step was to outline executive roles, and this was done, as well as reinforced by, skill training in modern management. A large amount of this training was actually performed by an Afghan employee with a Human Resource Masters Degree. At the same time, job descriptions were prepared for all DAB staff. This was done for all PRR employees in 2003, with updates the following year. Due to changes within *Da Afghanistan Bank*, both prior and forthcoming, recurring updates should be performed.

Any open positions, due to this reform, were staffed by means of PRR processes and open interviews. This usually resulted in the best candidate being chosen for the job. Due to low skill levels within the nation, a number of these positions were assigned to individuals needing both capacity building and general job training. As a whole, a majority of the new positions were assigned to already-employed DAB staff members. In cases where skill sets were not found internally, external candidates were recruited.

Finally, a *Redeployment Plan* was designed in 2003; however, as mentioned in the prior section, the GOA has impeded the plan's aim. DAB should therefore delay this reform plan and prepare any peripheral items open to change. Although delayed in this task, DAB was able to consolidate contract work by designing and implementing a plan, which placed all contract workers under the General Services Department.

➤ *Training and Capacity Building*

Training was a foremost priority under the *Human Resource Reform Project*, leading to numerous gains for both DAB and its staff members. In order to design a mission with precise goals, a *Master Training Schedule* was initially developed in 2003 and later revised by DAB's Management and Development staff. The plan called for training in core topics, such as a) English, b) Information Technology as well as c) Accounting and included the creation of a training center within DAB.

Establishing the aforementioned training facility was a major milestone under the project and reflected coordination between USAID and the *Swedish International Development Cooperation Agency* (SIDA). In addition, the International Monetary Fund (IMF), again in cooperation with the USAID reform project, administered the provision of a training coordinator as well as numerous training courses and training center support. Finally, more high-level courses were administered, although these were led by the technical advisors themselves or guest advisors from the IMF. Strategic partnerships with other central banks in the region have also been developed to allow specialized training and promote a broader range of capacity building.

➤ *Benefits of Capacity Building*

As a result of both training and capacity building, a number of DAB sections can now sustain operations on an *Afghan only* basis. This distinction is listed in the “Training Areas and Associated Benefits” table at the end of this section and is a major achievement for the Economic Governance Program as well as DAB. In fact, six of twelve functional areas in DAB have been deemed sustainable on *Afghan only* terms.

Here is a more in-depth look, with respect to capacity building results:

- The *Supervision Department* is staffed and run by Afghans, with coaching and training advice by the technical advisors. It has produced the Afghanistan banking legislation and regulations, licensed 11 commercial banks, executed 8 onsite bank examinations, performed basic offsite analysis of all banks and analyzed trends in the banking sector as a whole.
- Additionally, the *Payments Unit* is staffed and run by Afghans, with periodic review and advice from technical advisors. It has increased transaction handling by 1,000 percent, since the beginning of the *Economic Governance Program*.
- The *bank staffing process* – through the Priority Reform and Restructuring (PRR) Program – is managed by Afghans in Human Resources, with input from technical advisors. Posts are filled through the consensus of Afghan directors, at Human Resource Committee meetings.
- The *Short-term Financial Instrument* process in the Market Operations Department is handled completely by Afghans, with peripheral technical aid.
- Most functions within the *Market Operations Department* are managed *Afghan only*. In fact, the Afghan delegated with administering the Capital Note has fully assumed the duty and is well acquainted with both its software and theory. He is also responsible for conducting daily auctions.
- Core training for PRR bank staff appointees, in the DAB Training Center, is managed completely by Afghans.
- Weekly and monthly sweeps for the Ministry of Finance revenue accounts are executed almost independently. Any missing transactions are reconciled by the *Branch Coordination Unit* in Kabul City.
- The DAB Afghan liaison, between the Ministry of Finance and DAB, handles all liaison tasks for the *weekly* and *monthly sweeps*.

- The Hajj and NSP payment programs, which generate thousands of transactions, are being administered by Afghan staff. The NSP program manager coordinates payments across the country, serves as the primary liaison with the NSP oversight consultant team and collaborates with Afghan staff to resolve payment delays or problems, as they happen.
- The payment of *Individual Salary Payments* (ISP) Program payments in Kabul, to some 30,000 GOA employees, has been managed and performed by the General Director of Bank Operations as well as DAB staff.
- The *Bagram Branch*, using all new transaction forms and branch accounting systems, is managed and operated by DAB staff. Generally, service to the US Army, NSP and non-government key accounts is handled by DAB employees and local BearingPoint Afghan staff.
- Afghan staff members have been trained in *customer service* for non-government accounts, such as the US Army, NGOs as well as commercial banks. The US Army is one of the largest and most profitable relationships for DAB, and service is now being provided almost exclusively by Afghan staff.
- DAB staff has handled a significant increase in *current account transactions*, with the computerization of account records and without adding staff. This has included a) transaction entry, b) checking and approval, c) balance updates, d) generation of statements and e) special reporting for the Monetary Policy Department, the Market Operations Department as well as the MOF. Specific examples include:
 - Treasury vault handled by DAB staff,
 - MOF and government accounts managed by DAB staff,
 - Non-government accounts handled by DAB staff,
 - Branch input coordination managed by Afghans and
 - Daily balancing of cash and non-cash vouchers handled by Afghans.
- In *Accounting and Financial Services*, Afghans are performing the following:
 - Data processing of vouchers,
 - Branch reconciliation and
 - Post-process auditing of vouchers.

| <i>Training Areas and Associated Benefits</i> | <i>- - - - -</i> |
|--|-------------------|
| On-the-job Training Hours at DAB | 567,000 + |
| On-site <i>Specialty Courses</i> | 16 |
| Employees Enrolled in 1 or More <i>Local Courses</i> | 156 |
| Employees Trained in 2004 / 2005 <i>Specialty Courses</i> | 108 |
| Key Employees Attending 2004 / 2005 <i>Away Courses</i> | 32 |
| Functional Areas Capable of Operating <i>Afghan only</i> | 6 of 12 |
| <i>Additional Revenue</i> Generated by <i>Afghan only</i> Operations | \$22,000,000 / yr |
| <i>Afghan only</i> Commercial Bank Licensing | 11 |
| Increase in Money Transfers – <i>Afghan only</i> Operation | 300% |

➤ *Finance and Accounting*

At the onset of the project, DAB's *Finance and Accounting Department* was initially assessed and subsequently restructured into separate but interactive groups. Most of the existing staff members were replaced, through open enrollment processes and competitive examinations. This included a written examination on international accounting and financial reporting standards as well as an oral examination, aimed at assessing a candidate's competence for a well-defined set of tasks.

The *Accounting Department* was further restructured into a decentralized system, with integrated branch accounting functions operating in accordance with international accounting standards. Due to a lack of complete and timely data submission from the branches, task forces of bank inspectors were often dispatched to collect any necessary data from the regions. Once repairs to the infrastructure and communications systems are complete, this problem should be largely mitigated. Furthermore, a *Budget and Planning Division* was formed, as a separate and discrete function within the *Finance and Accounting Department*. The new section was subsequently staffed, using the same competitive procedures described above.

Reform also focused on establishing a core set of policies and procedures for the *Finance and Accounting Department*. In the financial statement “notes,” for Afghanistan’s fiscal year ending March 20, 2004, DAB’s revised accounting policies and procedures were defined. To the largest extent possible, they conformed to international standards and were therefore accepted by DAB’s Governor, Deputy Governors as well as the external auditors. Although incomplete, due to the pending acquisition of a general ledger package, an interim manual was prepared to capture these policies and procedures. In fact, an interim MS Access-based system was installed, until the general ledger system is procured and set in place. The interim system has facilitated the daily balancing of both cash and non-cash transactions, while also generating balance summary reports.

Moreover, a preliminary *Chart of Accounts*, based on the requirements of international accounting and financial reporting standards as well as the reporting needs of the International Monetary Fund (IMF), was developed for DAB use. Instructions were not developed at that time, since the *Chart of Accounts* will need updating after the general ledger package is installed. In light of this, it might be wise for the software supplier to provide operating instructions and train staff members.

In addition, and in order to activate the *Internal Audit* function, a BearingPoint local employee, who originally acted as the Accounting Advisor’s senior assistant, was promoted to Deputy Chief Internal Auditor. Unfortunately, recruiting efforts could not identify a Chief Internal Auditor. Fortunately, the Deputy was able to build a nucleus of internal audit staff from qualified staff in the *Finance and Accounting Department*.

Finally, formats and procedures for issuing financial statements and numerous analytical reports were also designed. Training in these processes was administered to staff from the newly-assembled *Finance and Accounting Department* as well as other DAB sections. Due to a lack of computers, however, this reform effort could not be implemented on the scale desired.

That being said, DAB’s financial statements and annual report for Afghan year ending March 20, 2004 were prepared and subsequently submitted to an independent auditor. The DAB Annual Report represented a monumental achievement for the project, as it included the first *International Accounting Standards*-compliant Balance Sheet, since 1996. General agreement was reached with the auditor’s recommendations, and these were considered when preparing statements for Afghan year ending March 20, 2005.

Legal & Regulatory Technical Sector

- Afghanistan's Ministry of Communications

Competition Policy and Public Utilities

Sound competition policy seeks both to preserve and sustain competitive markets, while increasing competition for a nation's natural monopolies. As in most cases, these monopolies predominantly arise within public utility sectors, and a major vehicle for promoting competition in this arena is the development and implementation of a regulatory body with oversight capabilities. Ideally, this agency should be wholly independent and capable of producing long-term results.

The project's methodology for accelerating the development of a legal and regulatory framework within Afghanistan was analogous to the methods previously employed in both Iraq and Kosovo. As a result, international best practices were often used as baselines, with advisors leveraging lessons learned from these prior experiences. In addition, Afghanistan set the stage for greater sophistication in establishing a well functioning Telecom Sector regulator, producing new and invaluable lessons learned along the way.

➤ *Draft Telecom Law*

A critical piece in the development of a legal and regulatory framework for Afghanistan's Telecom Sector was the drafting of a comprehensive Telecom Law. BearingPoint advisors, with local staff member assistance, endeavored to accomplish this aspect of the project and later presented the law to the Ministry of Justice. When the Telecom Project came to an end, formal presentation of the Telecom Law to Afghanistan's Cabinet was scheduled for August 29, 2005.

The proposed Telecom Law includes provisions for both foreign and private investment in Afghanistan, in order to rapidly develop the Telecom Sector. At the same time, the law will make it easier for outside investors to enter the market, minus excessive regulation and intense bureaucratic pressure. In addition, a number of checks and balances were included to make the proposed Telecom Regulatory Agency (TRAA) legally responsible under the new schema.

Acceptance of the Telecom Law is a prerequisite for a number of additional reforms. For example, installation of a truly autonomous sector regulator (in this case the proposed TRAA) is only possible with the law firmly in place. Formal adoption of the law is also required to recruit and subsequently train all TRAA board members (a 5-member board is being proposed). Nonetheless, job descriptions for these members have been developed ahead of time to facilitate the process, and all candidates will be formally appointed by the *Council of Ministers*.

➤ *Installation of an Interim Regulator*

As mentioned on the prior page, full promulgation of the Telecom Law is required for the installation of an autonomous regulatory agency, namely the proposed Telecom Regulatory Agency (TRAA). As a result, an interim regulator was established within the Ministry of Communications and is called the Telecom Regulatory Board (TRB). This oversight body is fully operational and will be converted into a genuinely autonomous GOA agency, upon formal adoption of the Telecom Law. The following steps were needed to *install* and *staff* the TRB:

| Task Name | Status |
|---|--------|
| Draft Ministerial Decree to establish <i>Telecom Regulatory Board</i> | ✓ |
| Facilitate signing of Decree by the Minister of Communications | ✓ |
| Develop <i>terms of reference</i> for TRB members | ✓ |
| Draft <i>normative acts</i> for the Board | ✓ |
| 1) Draft TRB Rules of Procedure | ✓ |
| 2) Draft TRB Rules of Ethics | ✓ |
| 3) Draft Decision on License Categories | ✓ |
| 4) Draft Decision on Numbering Plan | ✓ |
| 5) Draft Decision on Frequency Table | ✓ |
| 6) Draft Schedule of Regulatory Fees | ✓ |
| 7) Draft Schedule of Penalties and Fines | ✓ |

| Task Name | Status |
|--|--------|
| Facilitate adoption of these rules by the Board | ✓ |
| Prepare <i>job descriptions</i> for key staff members | ✓ |
| 1) <i>Head of Regulatory Branch</i> | ✓ |
| 2) <i>Director of Licensing</i> | ✓ |
| 3) <i>Director of Rates and Tariffs</i> | ✓ |
| 4) <i>Economist</i> | ✓ |
| 5) <i>Chief Financial Officer (CFO)</i> | ✓ |
| 6) <i>Human Resource Development Officer</i> | ✓ |
| 7) <i>Public Affairs Officer (PAO)</i> | ✓ |
| 8) <i>Management Trainees</i> | ✓ |
| 9) <i>Technical Standards Officer (TSO)</i> | ✓ |
| 10) <i>Webmaster</i> | ✓ |
| Translate all <i>job descriptions</i> into the Dari Language | ✓ |
| Develop TRB <i>Recruiting Strategy</i> | ✓ |
| Phase One of <i>Recruiting</i> – prior to Telecom Law adoption | ✓ |

| Task Name | Status |
|--|--------|
| Meet with all possible <i>staffing resources</i> | ✓ |
| 1) Kabul University <i>faculty heads</i> | ✓ |
| 2) <i>International Organization for Migration</i> | ✓ |
| 3) <i>Civil Service Commission</i> | ✓ |
| 4) <i>Ministry of Labor and Social Welfare</i> | ✓ |
| Staff Training | ✓ |
| 1) Upgrade Training Room | ✓ |
| 2) Develop Training Materials | ✓ |
| Establish <i>Human Resource Program</i> | ✓ |
| 1) Prepare <i>Orientation Materials</i> | ✓ |
| 2) Develop <i>Employee Database</i> | ✓ |
| 3) Develop <i>Employee Handbook</i> | ✓ |
| 4) Establish Internet <i>research stations</i> | ✓ |

| Task Name | Status |
|--|--------|
| Establish TRB website (www.trb.gov.af) | ✓ |
| 1) Develop <i>content outline</i> | ✓ |
| 2) Coordinate with MoC IT staff members | ✓ |
| Implement <i>Public Relations Campaign</i> | ✓ |
| 1) Prepare PR <i>briefing packages</i> | ✓ |
| 2) Compile <i>journalist roster</i> | ✓ |
| 3) Plan a TRB <i>press conference</i> | ✓ |
| 4) Hold <i>press conference</i> | ✓ |
| 5) Publish PR information (www.trb.gov.af) | ✓ |
| Establish Capacity Building Programs | ✓ |
| 1) <i>Fundamentals of Business</i> | ✓ |
| 2) <i>Regulatory Mission</i> | ✓ |
| 3) <i>Authorizations and Licenses</i> | ✓ |
| 4) <i>Interconnection Principles</i> | ✓ |
| 5) <i>Numbering Principles</i> | ✓ |
| 6) <i>Frequency Allocation and Assignment</i> | ✓ |
| 7) <i>Dispute Resolution</i> | ✓ |

| Task Name | Status |
|---|--------|
| Promote <i>Private Sector Participation</i> (PSP) | ✓ |
| 1) Introduce <i>Licensing Regime</i> | ✓ |
| 2) Develop <i>Fixed Telephony Licensing</i> (FTL) strategy | ✓ |
| 3) Facilitate TRB's adoption of this policy | ✓ |
| 4) Organize PSP <i>press conference</i> | ✓ |
| 5) Guide local staff in writing PSP <i>support materials</i> | ✓ |
| 6) Solicit <i>public comments</i> on PSP policy | ✓ |
| 7) Guide local staff in the <i>analysis</i> of these comments | ✓ |
| 8) Prepare collection of comments and recommendations | ✓ |
| 9) Develop FTL <i>requests for proposals</i> (RFP) | ✓ |
| 10) Launch international <i>competitive tender</i> | ✓ |
| 11) Organize RFP <i>press conference</i> | ✓ |
| 12) Assist with <i>bid evaluations</i> | ✓ |

| Task Name | Status |
|--|---------|
| Establish TRB <i>Pricing, Accounting and Cost Management</i> policies | ✓ |
| 1) Draft <i>Use of Universal Access Funds</i> white paper | ✓ |
| 2) Conduct <i>tariff study</i> on <i>domestic rates</i> | ✓ |
| 3) Compare <i>study findings</i> with <i>neighboring nations</i> | ✓ |
| 4) Realign licensing regime – <i>frequency assignment fees</i> | ✓ |
| 5) Develop penalties and fines – <i>enforcement fees</i> | ✓ |
| 6) Develop both TRB and TRAA budgets (first year) | ✓ |
| 7) Implement <i>tariff rebalancing</i> | Delayed |
| 8) Establish <i>service authorization fees</i> | Delayed |
| 9) Establish licensing fees <i>equal to or greater than regulation costs</i> | Delayed |
| 10) Examine, recommend and implement <i>licensing fees</i> | Delayed |
| 11) Facilitate <i>Network Interconnection Agreement</i> | ✓ |
| 12) Conduct research on <i>regional interconnection policies</i> | ✓ |
| 13) Prepare benchmark study on <i>interfaces and commercial terms</i> | ✓ |
| 14) Issue policy for <i>interconnection mediation or arbitration</i> | ✓ |

| Task Name | Status |
|---|--------|
| Establish a sound <i>Monitoring and Enforcement Program</i> | ✓ |
| 1) Develop GSM <i>license compliance</i> monitoring system | ✓ |
| 2) Develop <i>Quality of Service</i> targets | ✓ |
| 3) Conduct <i>Mobile Drive Tests</i> | ✓ |
| 4) Define <i>Mobile Drive Test</i> requirements | ✓ |
| 5) Identify GSM <i>drive test equipment</i> vendors | ✓ |
| 6) Issue <i>training</i> and <i>equipment quotation solicitations</i> | ✓ |
| 7) Select <i>Mobile Drive Test</i> vendor | ✓ |
| 8) Conduct GSM <i>Mobile Drive Test</i> in Kabul City | ✓ |
| 9) Examine <i>test results</i> and compare with <i>license requirements</i> | ✓ |
| 10) Meet with GSM licensees to discuss <i>test results</i> | ✓ |
| 11) Develop recommendations for <i>remedial action</i> (if applicable) | ✓ |
| Examine GSM licenses for <i>compliance with network requirements</i> | ✓ |

➤ *Human Resources Development*

Within the Telecom Regulatory Board (TRB), the first training priority was to recruit and hire a Human Resource Development (HRD) Officer. The new HRD Officer was immediately trained and is now responsible for ensuring that all TRB staff members follow a well-defined career path. In fact, a major element of each career path is mandatory training, which forms a significant basis for the employee evaluation process (taking place every 6 months). As part of this process, a Human Resources Manual was prepared for the TRB, which outlines policies for recruiting, staff orientation as well as long-term performance guides (training).

The HRD Officer was hired in September 2004 and was initially responsible for recruiting, hiring and training 15-20 new candidates as entry-level Management Trainees. In doing so, he visited Kabul University and met with all faculty heads: Law, Economics, Engineering and others. At the same time, he recruited candidates at a number of Afghan Ministries and organizations. By October 15, 2004, the HRD Officer had enlisted 20 new staff members (each hired on a provisional basis), and in accordance with new standard operating procedures, each new hire had to maintain formal classroom training (see below). By January 15, 2005, the Minister of Communications awarded 18 staff members with training completion certificates.

➤ *Formal Training: Introduction to Telecom Law and Regulation*

As mentioned above, the 20 new staff members were required to attend formal training (failure to attend resulted in termination). The training class, entitled *Introduction to Telecom Law and Regulation*, was administered from October 15, 2004 to January 15, 2005. Below is an outline of what the training sessions entailed:

- Two meetings each week, for a duration of two hours. In addition, a weekly *Internet Lab* was made available for numerous research and writing assignments.
- Open-book *examinations* were administered at the conclusion of each week.
- A *support mechanism* and *reference materials* were incorporated into the training syllabus.
- All outlines, syllabi and test questions were uploaded to the TRB website:
 - http://www.trb.gov.af/training_outline_10_16_2004.htm
 - <http://www.trb.gov.af/Training%20materials.htm>.

➤ *Guidance for Future Reform*

As noted in prior sections, formal adoption of the Telecom Law is a prerequisite for a number of additional reforms, such as the adoption of a truly autonomous Telecom Sector regulator (the TRAA). At the same time, the following items must be closely monitored in the medium and long terms.

▪ *Private Sector Reform*

A prerequisite for reform within the Telecom Sector is willingness by the Ministry of Communications to allow and foster greater *private sector participation* in Afghanistan, the only viable medium to increase the availability of affordable telecom services within the country. In order to be of use, this policy must be written, long-term in scope and formally promoted.

Initially, the Minister of Communications needs to adopt a *ministerial decree*, which clearly delineates the following factors: policy, regulation as well as service provision. Ideally, this decree would also consolidate the ministry's telecom operations into a single enterprise, setting in motion the processes of *corporatization* and *privatization*. At the same time, it should define the powers of the independent regulator and spread its influence among all board members (the TRB is now residing within the Ministry of Communications on an interim basis).

▪ *Independent Regulator*

When the interim regulator becomes a fully self-directed body, it will be especially important to protect its independence. In order to do so, the agency must be endowed with its own budget (ideally as a distinct budget organization). In addition, human resource development must be a priority from the beginning. This is best achieved by immediately hiring a Human Resource Development Officer when the autonomous agency is established (namely the TRAA). In post-conflict economies, both regulation and market concepts are new ideas; therefore training should be a mandatory condition of employment.

When the TRAA is finally established, it should be managed as a “green field” agency. In this scenario, the regulator will hire the most qualified candidates, in accordance with pre-defined criteria and standard operating procedures. This approach will also position the Ministry of Communications as an institution rewarding on the basis of *merit* and *skill*, rather than *patronage* or *corruption*. As a corollary to this, the remaining regulatory function within the ministry itself should cease all hiring, in an effort to gradually shrink its operations. Early retirement would be the ideal solution; however, most emerging economies lack a viable pension system.

- *Salary Structure Reform*

Another item needing analysis is the *salary structure* within the telecom regulatory agency. In order to retain the agency's personnel, salary increases will be needed to compete with a growing demand, stemming from NGOs and other employment options. In theory, an independent regulator will possess a higher wage ceiling, due to its budget being fully replaced by regulatory fees. This is a basic reason for the rapid establishment of an independent regulator, capable of offering higher wages and initiating capacity building (with the aim of retaining a core group of professionally trained staff members to guide the agency's future).

- *Afghan Wireless Communications Company (AWCC)*

The Ministry of Communications owns twenty percent of the Afghan Wireless Communications Company, which is one of the incumbent nationwide mobile (GSM) service providers. At the same time, five offers for two additional GSM licenses (via international competitive tender) were submitted to the Afghan Government on August 16, 2005, consequently making the Government's ownership considerably greater in total value. As a result, this favorable set of conditions warrants a sale of this share, thereby a) fully exonerating the Ministry of Communications of its AWCC obligations and b) promoting greater transparency among the a) private sector, b) regulatory agencies and c) the Ministry of Communications itself.

- *Conditional Aid for Infrastructure*

USAID and other donor agencies have provided funds for telecom infrastructure projects within Afghanistan. These include the *Government Communications Network* (GCN), which manages satellite-based connections among Afghanistan's thirty-four regional capitals, and the *District Communications Network* (DCN), managing smaller-scale connections among the 329 (approximately) district government locations. Projects such as these are critical, as they allow real-time communications with the central government (on a nationwide scale).

As exclusive-use networks, they are essential for the promotion of good governance as well as democracy; however, long-term policies must avoid displacing private sector solutions. In fact, the possibility of donated infrastructure resulting in the creation of new zones of monopoly service must be avoided completely. In order to do so, donors should be especially mindful of their allocation of forthcoming assistance for public utility sectors. Funding should be granted only if other agencies are able to simultaneously enter Afghan markets.

➤ *Afghan Telecom Limited*

In September 2003, the Ministry of Communications (MoC) directly operated *fixed line telecommunications services* in Kabul, Herat, Jalalabad, Mazar-e-Sharif as well as Kandahar, using network equipment funded by both the World Bank and Asian Development Bank (ADB). In discussion with the World Bank, the Ministry agreed to engage in a process of transferring all operations to a corporation, which would be created and subsequently privatized, namely Afghan Telecom Limited (ATL). This process, in compliance with World Bank guidelines, was called *corporatization*.

A presidential decree was therefore prepared in the fall of 2003 to allow for a) the formation of Afghan Telecom, b) ATL funding and c) the transfer of all assets, human resource functions as well as any rights or liabilities connected with the operation of telecommunications services from the MoC to Afghan Telecom. The *Corporatization Decree* was initially signed by the President in May 2004; however, due to opposition from the Ministry of Justice, the decree was amended and submitted again to the Afghan Cabinet. As a decree, it was ultimately accepted in the summer of 2005, together with the ATL by-laws.

Afghan Telecom was formed by re-assembling the MoC *Telecom Department*, while the processes for accepting the decree as well as the by-laws took place. At the same time, a management team was formed in mid 2004, based on a modern telecom carrier model. Finally, the human resource function was re-assigned and staff members re-hired by way of the Priority Reform and Restructuring (PRR) Program or outside sources. In addition, *Finance* and *Marketing* sections were installed.

As a result of these reform measures, Afghan Telecom began managing the roll-out of networks to all *regional capitals*, using the *Government Communications Network* – a long-distance satellite network, designed to manage traffic from Afghan Telecom retail customers as well as GoA offices. At the same time, a separate *District Communications Network* was installed, using USAID funding, to furnish communication in *rural districts*. When its inaugural Board of Directors meeting took place in September 2005, Afghan Telecom had a complete organization with steady operations. ATL is now offering commercial services to more than 40,000 subscribers as well as the Afghan Government.

At the same time, a list of buildings and land properties, for transfer to Afghan Telecom as per the *Corporatization Decree*, as well as network equipment was prepared. At the end of the project, the MoC was reviewing these lists, in order to execute a legal transfer of property in the coming months. Furthermore, any contracts are now being reviewed, but transfers have not taken place, since they mainly include donors as signatories and relate to assets that must be transferred separately.

Finally, legal due diligence is underway and will finalize any legal arrangements. At the same time, a business plan was developed, identifying all funding requirements, negotiated and executed in cooperation with the Ministry of Finance. While the original plan called for assigning a mandate to a managing partner as well as the transfer of any management responsibilities, the Ministry of Communications' endorsed schema has chosen traditional privatization instead.

Legal Reform

➤ *Da Afghanistan Bank Law*

- Submitted to the *Taqnin* – Ministry of Justice *legislative branch*

At the close of the Legal Reform Project, two drafts and two enacted laws had been furnished for the Law of Banking. As is customary, Pashtu and Dari translations were prepared and subsequently submitted to the Ministry of Justice. Upon receipt, the *Taqnin* was therefore responsible for publishing both the a) Law of Banking and b) DAB Law itself. The DAB Law is # 819 in the *Official Gazette*.

➤ *Afghan Telecom Corporatization Decree – ATCD*

- Submitted to the *Taqnin* – Ministry of Justice *legislative branch*

The Afghan Telecom Decree was one of the top priority items under the economic governance legislative agenda. In working with the Minister of Communications, the strategy of repealing the decree's Template Charter, instead of merely exempting Afghan Telecom from its highly restrictive terms, was permitted. This repeal of the Soviet-era charter was an important goal in its own right, in order to prevent government interference with the flexibility of a) private and b) government business to design corporate charters for its needs.

As a result of pressure from the *Taqnin*, the ATCD required a series of changes and continual legal analysis and discussion. The *Taqnin* finally agreed to a) begin the Pashtu translation and b) publish the decree in the *Official Gazette*. The ATCD is therefore a formal legal instrument (legally binding in Afghanistan), and consequently, Afghan Telecom was incorporated in June 2005.

Finally, progress was made on the implementation of the ATCD, which resulted in the creation of a Working Group to a) set up and b) administer the Afghan Telecom Corporation (ATC). As part of this group, BearingPoint was involved in the drafting and translation of all ATC legal instruments, including the Articles of Incorporation and Bylaws.

At the close of the Legal Reform Project, the numerous bylaws were accepted by an Inter-ministerial Consultation Group (which included the Ministries of Communications, Justice, Commerce, Finance and Economy) and were subsequently scheduled for submission to the Afghan Cabinet.

➤ *Industrial Parks Decree*

- Submitted to the *Ministry of Commerce*

The Industrial Parks Decree was initially drafted and later submitted to the Ministry of Commerce. In addition, the Legal Reform Project guided its translation into Pashtu, while awaiting examination by the Ministry of Commerce. As a result of the Legal Reform Project's completion, actual enactment of this law was not under the direction of the AEG Program.

➤ *Private Investment Law*

- Submitted to the *Afghan Cabinet*

The Private Investment Law was initially submitted to Afghanistan's Cabinet, but rejected in light of a pending agreement between the Ministry of Justice, Ministry of Finance and Ministry of Commerce on its *fiscal, financial and tax provisions*. At the request of the Minister of Commerce, examination of the law was reinstated, and at the conclusion of the Legal Reform Project, approximately two months of translation, redrafting as well as lobbying remained for full enactment. Nonetheless, the Private Investment Law was initially a) translated, b) submitted to the Taqin and c) placed under Ministry of Justice analysis.

➤ *Anti-Money Laundering and Criminal Income Law*

This comprehensive law was a) drafted in concert with the IMF, b) translated and c) submitted to the Taqin for review. Upon examination, the law was formally published and is now # 840 in the nation's *Official Gazette*.

➤ *Anti-Financing of Terrorism Law*

This comprehensive law was a) drafted, b) translated and c) submitted to the Taqin for review. Upon examination, the law was formally published and is now # 839 in the nation's *Official Gazette*.

➤ *Customs Law*

- Submitted to the *Taqin – Ministry of Justice legislative branch*

President Karzai promulgated the Customs Law, by way of decree, on March 30, 2005. This medium ordered the publishing of the law, through the *Official Gazette*, and copies were submitted to the International Monetary Fund, highlighting compliance with the IMF *Benchmark* deadline. Finally, the Legal Reform Project helped the Ministry of Justice in a) formatting the law for publication and b) including a copy on the ministry's website. The posting of this law was aimed at disseminating it, along with its provisions, to the general Afghan public.

➤ *Budget Law*

- Submitted to the *Ministry of Finance*

The Budget Law was successfully a) translated and b) submitted to the Ministry of Finance for analysis. At the conclusion of the Legal Reform Project, the law was nearing completion and therefore nearing submission to the Taqin. This law was an IMF Benchmark item and was therefore a priority item within the *economic governance legislative agenda*.

➤ *Bribery and Official Corruption Law*

This comprehensive law was a) drafted, b) translated and c) submitted to the Taqin for review. Upon examination, the law was formally published and is now # 838 in the nation's *Official Gazette*.

➤ *Draft Telecommunications Law*

- Submitted to the *Taqin* – Ministry of Justice *legislative branch*

The Legal Reform Project endeavored to adopt international best practices, modeled by other telecommunications regimes, and with the approval of Minister Sangin, a number were included in the law. At the conclusion of the project, the law was in the possession of the Taqin at the Ministry of Justice.

Finally, it seemed as though that the Taqin would have no objections to the provisions in the law, so little to no problems were projected from the Ministry of Justice. Following this analysis, the law was scheduled for introduction to a) the President's Office and later b) the Cabinet of Ministers.

➤ *Income Tax Amendments*

- Submitted to the *Taqin* – Ministry of Justice *legislative branch*

President Karzai signed the Income Tax Amendments on March 17, 2005. In fact, the lifecycle of this process represented the fastest *processing time* of any legal instrument, from presidential signature to publication. On March 20, 2005 the law formally appeared on the *Official Gazette*, as # 845.

➤ *Non-governmental Organization Law*

The Legal Reform Project was not directly responsible for this law; however, it was called on to monitor its enactment progress. At the conclusion of the program, the law had been discussed within the Afghan Cabinet and later referred to a legislative committee, chaired by Minister Farhang.

➤ *Procurement Law*

The Legal Reform Project was not directly responsible for this law; however, it was called on to monitor its *enactment progress*. At the conclusion of the program, the law had been discussed with Minister Arsala and noted as a priority for the Ministry of Commerce as well as a compliance item for the World Trade Organization. Due to drafting as well as translation issues, reform progress was hindered.

➤ *Fuel Licensing Regulations*

The Legal Reform Project developed a *draft* of this law and later submitted the piece of legislation to the Ministry of Finance. At the conclusion of the project, an inquiry by the team into whether or not the Ministry of Finance was keeping this item on its priority agenda was pending.

➤ *Customs Warehouse Regulations*

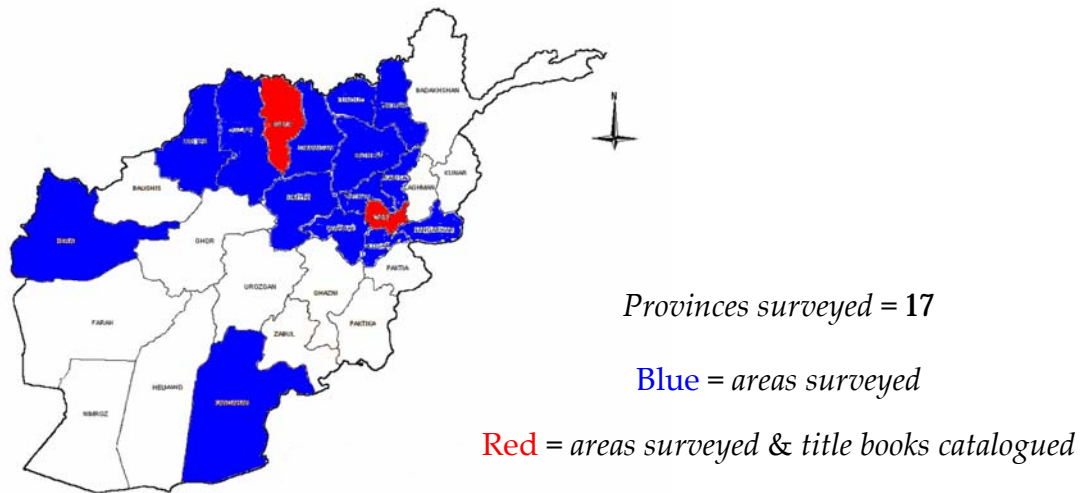
The Customs Warehouse Regulations were a) drafted and b) submitted to the Ministry of Finance for consideration.

➤ *Business Organizations Law*

Modifications were made to the Business Organizations Law, in accordance with Afghan International Chamber of Commerce guidelines. The law was successfully translated and placed under working group review.

Property Rights Project

➤ Land Titling: Provincial Surveys and Reorganization



The *Property Rights Project* was a short-term project under the *Afghanistan Economic Governance Program*. Headed by the Legal Reform Team Leader, it was tasked with a) *surveying* deed registry books in seventeen different provinces, and b) where needed, placing *title deeds* within a *database platform* for both reliable and quick access. Here is a list of all regions under the project's umbrella:

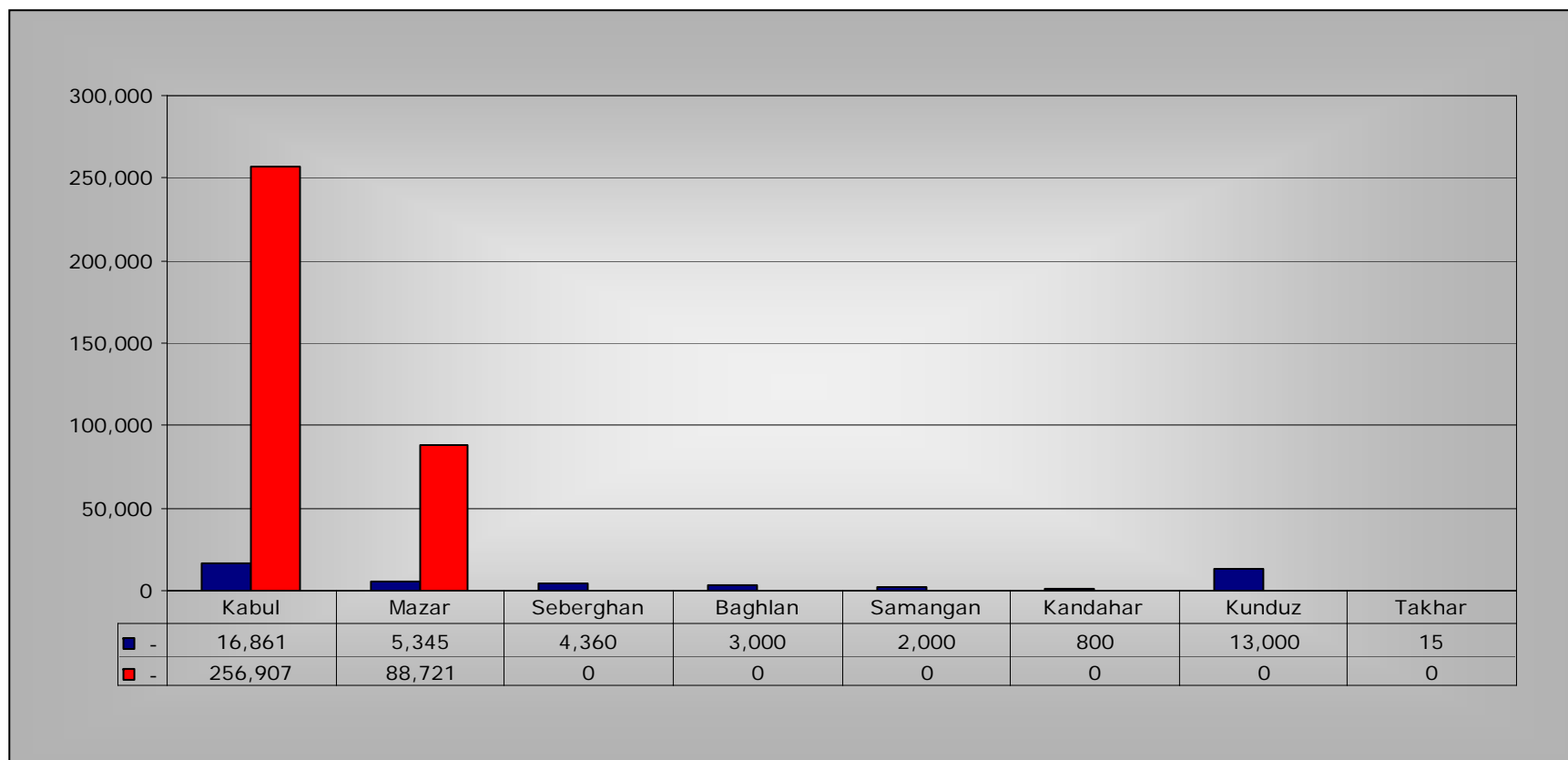
- Kabul City,
- Mazar-e-Sharif,
- Herat,
- Nengahar,
- Kandahar,
- Wardak,
- Logar,
- Kapisa,
- Parwan,
- Seberghan,
- Samangan, Baghlan, Kunduz,
- Takhar, Saripul, Faryab and Bamyan.

The following six pages include both *narrative* and *data* summaries of progress made in all of these regions.

➤ Provincial Results and Totals: Part One

Blue = Total number of *Deed Registry Books* surveyed = 58,025

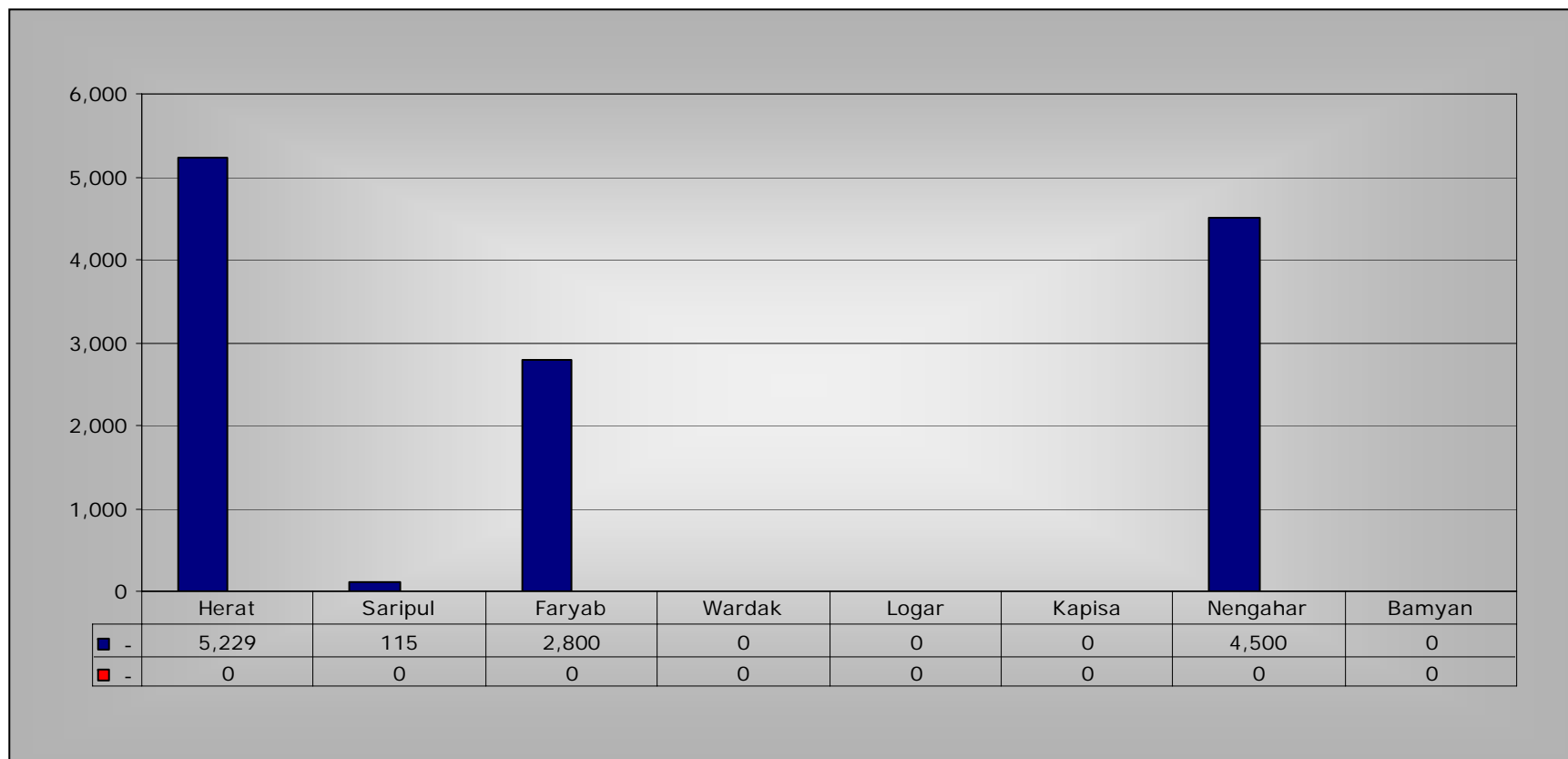
Red = Total number of titles in data base = 309,580



➤ Provincial Results and Totals: Part Two

Blue = Total number of *Deed Registry Books* surveyed = 58,025

Red = Total number of titles in data base = 309,580



➤ *Land Titling – Provincial Assessments*

■ *Kabul Appeals Court*

- Upon completion of the registration process, the total number of *ketab-e-kundas* (deed registry books) reached 16,861. Of this total, 6,332 were directly related to property, of which a total of 3,337 were *qabalas* (title deeds).
- The Kabul City *makhzan* (deed registry archive) was organized, with deed registry books sorted in logical order and placed in 70 new metallic cabinets (volumes containing legal documents were indexed). This significantly reduced research time and disrupted the monopoly of charging substantial fees for informal registry locator services.
- A user-friendly database was also developed for quick document access. In fact, legal documents for Kabul and Mazar-e-Sharif neared full integration. Additional functions for the database will be needed to gradually move the *makhzan* from a depository of deeds to a functional and elaborate data registry.

■ *Mazar-e-Sharif Appeals Court*

- A total of 5,345 deed registry books were indexed. Of this total, 3,506 records were not entered into the database, and 1,040 were *qabala* deed registry books (which represented 88,721 title deeds). These deed registry books were organized in logical order and placed in new cabinets. In addition, they were chronologically organized to facilitate document access.

■ *Herat Appeals Court*

- The Herat Appeals Court is currently located inside Herat's Walayat building, due to a lack of proper space. The storekeeper of the *makhzan* estimated a total number of 5,229 deed registry books.
- The *makhzan* was furnished with a total of fifteen cabinets. Deed registry was organized by a) district and b) year produced. In addition, all books were stored in a protective environment to better resist further deterioration or damage. Finally, local staff members were unable to furnish an estimated number of property-rights-related documents.
- There is a single *mahkama-e-shahree* – also known as a *city court* – and 15 provincial district courts.

■ *Nengahar Appeals Court*

- There are an estimated 4,500 *deed registry books* stored within the Nengahar *makhzan*, which date back to Afghan year 1305. The Deputy Head of Court was unable to provide an estimated number of *property-rights-related* documents. In addition, there are a number of *deed registry books* from both Laghman and Nuristan (up to Afghan year 1340) stored within the *makhzan*.
- A total of ten wooden cabinets reside within the *makhzan* and serve to organize the numerous documents, which are in good condition. The *makhzan* functions three days a week, and a commission (comprised of 1 storekeeper and 2 judges) operates on these scheduled days.
- UNDP was responsible for rehabilitating the building.

■ *Kandahar Appeals Court*

- An estimated 800 *deed registry books* reside within the *makhzan*. According to its storekeeper, more than 12,000 *deed registry books* were stored at one time, but more than 90% of the documents were destroyed or looted by gunmen. Finally, the Head of Court furnished thirteen metal cabinets.
- This location monitors 17 *provincial* and 6 *municipality primary courts*.

■ *Wardak Appeals Court*

- The Wardak Appeals Court has suffered from a significant amount of damage. The building itself was destroyed by rockets and gunfire and is now residing in a home. All *deed registry books* were reportedly burned, as ordered by the Taliban regime.
- Applicants are referred to the *Supreme Court* to obtain duplicate legal documents.

■ *Logar Appeals Court*

- The Logar Appeals Court has also suffered from damage. Pre-1354 *deed registry books* reside within the Kabul Appeals Court *makhzan*, while post-1354 records have been looted or destroyed by gunfire. No *deed registry books* reside within the building itself, which lacks adequate storage space. Management Systems International – MSI – has been chosen to erect a new court building.

■ *Kapisa Appeals Court*

- The Kapisa Appeals Court *makhzan* also suffered significant damage from the war. All of its legal documents have been looted or burned, and no legal documents currently exist within the *makhzan* itself. Primary courts that have completed *deed registry books* store them in their own cabinets.

■ *Parwan Appeals Court*

- The Parwan Appeals Court is currently under reconstruction by MSI, with daily activities halted, in light of reconstruction efforts. The Deputy Head of Court could not provide an estimated number of existing *deed registry books* within the *makhzan*.
- *Deed registry books* are currently laid down in two separate rooms and are not in good condition. At present, it is extremely difficult to find a single document and sometimes there is no result. The court reconstruction project is scheduled to last beyond four months.

■ *Seberghan Appeals Court*

- There are an estimated 4,360 *deed registry books* (starting from 1297 SH to 1380 SH) within the Seberghan *makhzan*. Post-1380 books have not yet been received by the Appeals Court, and currently, a total of fourteen *primary courts* are covered by the Seberghan Court.
- Books are currently kept in the *makhzan* and are not in good condition. They are mainly kept on the floor, which leads to more deterioration and long-term damage. Physical renovation of the courthouse itself is being completed by the Provincial Reconstruction Team (PRT).

■ *Samangan Appeals Court*

- An estimated 2,000 *deed registry books* can be found within the Samangan *makhzan*. All cabinets have been provided by the Provincial Reconstruction Team, and the *deed registry books* are generally kept in good conditions. The *deed registry books* are currently being indexed and organized, and in addition, other assistance – painting, iron sheets for the *makhzan* windows as well as electricity wiring – has been provided by the PRT.

■ *Baghlan Appeals Court*

- An estimated 3,000 *deed registry books* exist within the Baghlan *makhzan*. Many of the books have been burned, and those that remain are stored in sub-standard conditions. No assistance was provided to the Baghlan Appeals Court.

■ *Kunduz Appeals Court*

- An estimated 13,000 *deed registry books* exist in the Kunduz *makhzan*, out of which 9,780 are related to property. There are approximately 3,000 title deeds within the *makhzan*, and the court building itself is under reconstruction by UNOPS, which has provided four wooden cabinets for operations.
- The overall condition of the deed registry books is fair.

■ *Takhar Appeals Court*

- The Takhar Appeals Court suffered significant damage during the war years, and only 15 *deed registry books* can be found within the *makhzan* (all from year 1380). Due to a lack of space, deed registry books are stored in a bathroom.

■ *Saripul Appeals Court*

- An estimated 115 *deed registry books* exist within the Saripul *makhzan*. Saripul was a former district of the Jawzjan province, so books were kept there.
- The condition of the deed registry books is sub-standard.

■ *Faryab Appeals Court*

- An estimated 2,800 *deed registry books* exist in the Faryab *makhzan*, out of which 250 are title deeds.
- There are currently no cabinets, so books are kept on the floor.

■ *Baymyan Appeals Court*

- The Legal and Regulatory Team Leader met with the Bamyan Governor to discuss property issues and the overall condition of property deeds in the province. It was discovered that no legal deeds are available; therefore disputes have been common.

➤ *Before and After Photos – Baghlan Province*



Trade Policy Technical Sector

- Afghanistan's Ministry of Commerce
- The Afghan Investment Support Agency – AISA

Trade Policy Reform

➤ *Trade Policy Strategy*

The Trade Policy Reform Project initially assessed Afghanistan's *vision*, with respect to trade policy and implementing strategies. By coordinating with the Ministry of Commerce, a policy paper, identifying a) the nation's mission statement as well as b) any linked goals, was developed and accepted by the Minister of Commerce. In order to provide the scope of the "Ministry of Commerce: Mission, Vision, Strategic Goals and Objectives" document, the mission statement and goals have been listed here:

- *Promote the establishment and implementation of a legal and regulatory framework necessary to ensure the efficient and equitable operation of a free market economy.*
 - General Goal / Objective 1.1: Ensure the development and effective implementation of a modern system of commercial legislation.
 - General Goal / Objective 1.2: Establish an open, consistent and transparent business environment by systematically addressing regulatory barriers to foreign and domestic trade.
 - General Goal / Objective 1.3: Develop effective systems for consumer protection and standards to ensure the safety and efficacy of goods on the domestic market and to promote the competitiveness of Afghan exports.
- *Integrate Afghanistan into the regional and global economy.*
 - General Goal / Objective 2.1: Pursue opportunities to liberalize and expand trade within the region.
 - General Goal / Objective 2.2: Pursue WTO Accession.
 - General Goal / Objective 2.3: Maximize the benefits of preferential market access agreements for Afghan exporters.
 - General Goal / Objective 2.4: Strengthen and modernize transit agreements.
 - General Goal / Objective 2.5: Develop effective policies and programs for trade facilitation.
- *Facilitate and promote the development of a dynamic, competitive private sector.*
 - General Goal / Objective 3.1: To encourage the development of the formal economy.
 - General Goal / Objective 3.2: To promote and facilitate domestic and foreign investment.
 - General Goal / Objective 3.3: To encourage development of competitive and innovative enterprises to increase exports and fulfill domestic demand.

- *Improve the capacity, effectiveness and efficiency of the Ministry of Commerce.*
 - General Goal / Objective M.1: Complete the restructuring of the MoC.
 - General Goal / Objective M.2: Develop and implement a plan for the restructuring and reform of the agencies, institutions and enterprises related to the Ministry.
 - General Goal / Objective M.3: Develop effective human resource capabilities for the MoC.
 - General Goal / Objective M.4: Identify, implement and regularly update the capacity building needs within the restructured MoC.
 - General Goal / Objective M.5: Foster strong coordination within the Ministry, between ministries and between donors in order to make effective use of available resources.

This *trade policy strategy* serves more than one function. It offers a long-term road map for trade policy functions and includes internal reform guidelines for the Ministry of Commerce itself. At the same time, it has been used as the basis for a) organizational restructuring, b) Priority Reform and Restructuring Program tasks as well as c) Afghanistan National Development Strategy – ANDS – submissions.

➤ *Regional and Global Integration*

As noted in the prior section, the *trade policy strategy* offers a road map for the Ministry of Commerce, enabling it to a) monitor current strategies, b) assess future trade opportunities as well as c) adopt regional integration initiatives within this long-term framework.

In summary, current international (non-regional) trade policy initiatives include preferential trade agreements with the a) United States (GSP preferences), b) European Union (everything but arms), c) Japan (LDC preferences), d) Canada as well as e) India. Aside from India, which has resulted in a substantial market share gain for Afghan dried fruits and nuts, these preferences continue to be largely unused today.

In order to add depth to the analysis of Afghan regional and global integration, the Trade Policy Reform Project focused on the *South Asian Free Trade Area* – SAFTA – as a means to reach these goals. In order to establish a context for existing regional trade initiatives and examine how potential membership in the *South Asian Free Trade Area* would benefit Afghanistan, the “SAFTA: Possibilities for Afghanistan” document was written and disseminated accordingly. As a result, Afghanistan was offered membership in the *South Asian Association for Regional Cooperation* – SAARC – in its 2005 annual summit.

■ *South Asian Association for Regional Cooperation Background*

The *South Asian Association for Regional Cooperation* (SAARC) was established in 1985 by the People's Republic of Bangladesh, the Kingdom of Bhutan, the Republic of India, the Republic of Maldives, the Kingdom of Nepal, the Islamic Republic of Pakistan and the Democratic Socialist Republic of Sri Lanka with the goal of promoting economic growth, social progress and cultural development within the region. Cooperation among the member states encompasses a number of initiatives ranging from environmental and forestry issues to biotechnology.

Increasing economic cooperation, regional integration and particularly intra-SAARC trade flows is a central goal of the member states with a long run objective of creating a South Asian Economic Union (SAEU). As a first step in this process, the member states implemented the SAARC Preferential Trade Agreement (SAPTA) in 1993. In proceeding to the next stage, in January 2004, the member states signed the agreement to form SAFTA with the goal of eliminating trade barriers within SAARC. SAFTA is scheduled to begin implementation in January 2006, with member states phasing down tariff and non-tariff barriers (NTBs) over the next ten years.

Participation in SAFTA could potentially offer many benefits for Afghanistan. Among the most significant would be freer trade with two of its largest trading partners – India and Pakistan. While trade with the other SAARC member states is comparatively small, deeper regional integration provides an opportunity for trade expansion with significantly increased market access for Afghan exports.

Although Afghanistan's current tariffs are quite low, SAFTA would also increase the openness of the domestic market – particularly if combined with efforts to improve trade facilitation and transit between SAFTA members. More open markets can provide meaningful benefits in terms of lower prices for consumers, greater competition and increased investment. Finally, this should presumably follow from membership in SAARC, which would provide deeper regional integration across a wide range of issues as well as policies.

Among the potential concerns regarding Afghanistan's membership in SAFTA are the implications for government revenues. Tariff revenues are the most significant source of government revenue, and as Afghanistan looks to develop a sustainable budget in the absence of donor support, revenue considerations will be a substantial issue. Concerns from policy makers will also include the impact on the development of domestic industry and the balance of payments, as Afghanistan works to address a growing trade deficit. Additionally, the possibility of trade diversion caused by SAFTA membership must also be considered, although this concern is mitigated by Afghanistan's relatively moderate *tariff regime*.

Finally, a number of other mediums were explored, in order to bolster *global market integration*. Accession into the *World Trade Organization* was one of these. Although there was a delay in getting the process underway, numerous tasks were initiated, and progress was made in developing a *Memorandum on the Foreign Trade Regime*, which is scheduled for completion in 2006. At the same time, staff members from the Ministry of Commerce prospered from a 3-month training course, sponsored by the *World Trade Organization*. Moreover, the *Trade and Investment Framework Agreement – TIFA* – was examined, and technical assistance was furnished in the way of supporting documentation as well as general consultations for the Minister of Commerce.

➤ *Priority Reform and Restructuring Program – PRR*

The restructuring and reform process at the Ministry of Commerce proceeded in several stages. First, it developed a strategic plan, as noted in prior sections, which stated its mission, goals and objectives in the context of its mandate and government priorities. Based on this document, the existing structure, functions and activities of the MoC were assessed in light of its revised goals. Following this analysis, a new organizational structure was proposed, delineating the shortcomings of internal operations and proposing methods to enhance core areas.

Since it was designed to meet the needs of a state-controlled economy, the structure of the ministry was entirely inadequate for the achievement of priorities within a market-based economy. As a result, a number of functions were rendered irrelevant, in light of changes in the economic vision for Afghanistan, while others are redundant across its many departments or other ministries.

As noted above, ministerial functions and activities were assessed, with discrete roles being formed in the process. Below, and on the following two pages, is a summary of these roles, grouped by a) policy, b) regulation, c) coordination, d) supervision and performance monitoring as well as e) support.

▪ *Policy*

The MoC is responsible for the formulation and implementation of policy, in line with government priorities and in each of its mandate areas. These areas include:

- Commercial Legal Framework,
- Consumer Protection and Standards,
- International Trade,
- International Transit and Trade Facilitation as well as
- Private Sector Development.

■ *Regulatory*

Under the state-controlled economic system, the MoC had a regulatory role exercised by the ministry itself as well as its secondary institutions. In this period, it regulated almost every aspect of domestic commerce and international trade. Since the new economic vision for Afghanistan is that of a private-sector-led, free-market economy, many of the regulatory roles of the MoC were eliminated.

The movement of Customs to the MoF eliminated much of the regulatory role of the MoC in international trade. Additional reform in Customs and trade procedures also decreased the regulatory role of secondary institutions under the MoC. Moreover, reform to business licensing procedures enhanced the process of establishing businesses.

Despite this progress, the additional reform of regulatory procedures remains a high priority. A major goal of the restructuring process is to formally establish a mechanism, able to systematically address barriers to trade. The following section lists the Ministry's regulatory roles:

- Business Licensing,
- Investment Licensing,
- Certificates of Origin,
- International Trade and Transit Documentation,
- Export Regulation as well as
- Standards and Consumer Protection.

■ *Service Delivery*

The business community is the primary client of the Ministry of Commerce. As a result, under the system of state control, it offered very few services. In the MoC, as well as throughout the Government, there is a renewed focus on the efficient provision of improved services to the public. The following sections describe the service delivery mechanism, current as well as planned.

- International Trade and Transit Documentation,
- Border Port Facilities,
- Business Licensing,
- Information Services,
- Investment Services,
- Export Development Services,
- Industrial Parks and
- Business Development Services.

■ *Coordination*

- Inter-Ministerial,
- Private Sector,
- Secondary Institutions,
- Donor Agencies and
- Intra-Ministerial.

■ *Supervision and Performance Monitoring*

- Financial Monitoring,
- Donor Implemented Projects,
- Secondary Institutions and
- Intra-Ministerial.

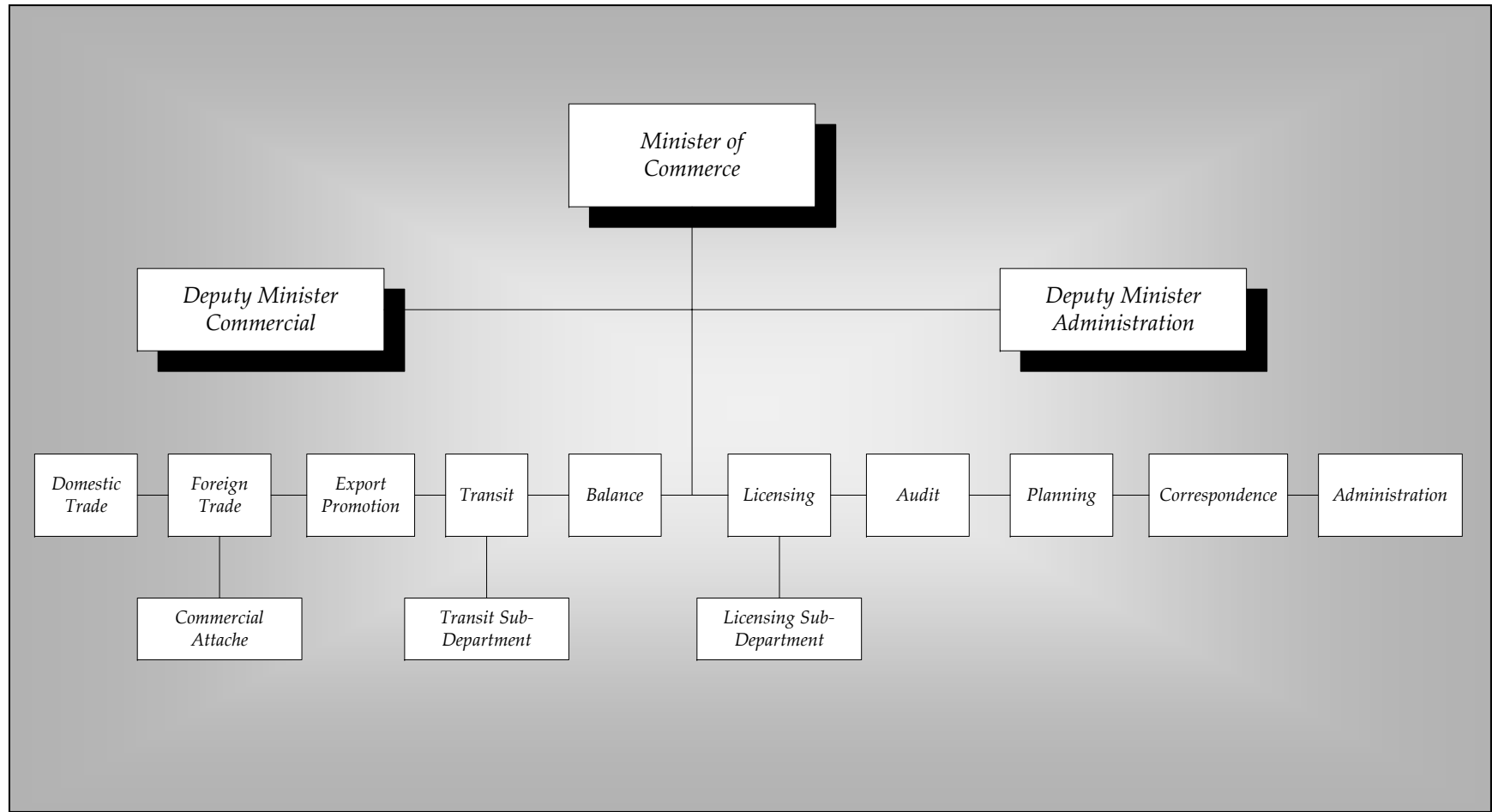
■ *Support*

- Intra-Ministerial Support of the Line Departments,
- Support of Other Ministries and
- Support for the Capacity and Development of the Private Sector.

Finally, the following page depicts the current structure of the Ministry of Commerce. Below the Minister, the Commercial and Administrative Deputy Ministers oversee the day-to-day operations of its ten departments. According to ministry statistics for 1383, the total number of staff members was 461. Here is a list of *employment by department* as well as the division of staff between *standard employees* and *contract staff*.

| Department | Employees | Contract | Total | % of Total |
|--------------------------|-----------|----------|-------|------------|
| Correspondence | 24 | 19 | 43 | 9 |
| Administration | 83 | 70 | 153 | 33 |
| Domestic Trade | 23 | 6 | 29 | 6 |
| Foreign Trade | 34 | 14 | 48 | 10 |
| Planning | 35 | 12 | 47 | 10 |
| Balancing and Accounting | 13 | 7 | 20 | 4 |
| Audit | 20 | 6 | 26 | 6 |
| Export Promotion | 15 | 7 | 22 | 5 |
| Licensing | 21 | 7 | 28 | 6 |
| International Transit | 35 | 10 | 45 | 10 |

➤ Ministry of Commerce Existing Structure



■ *Reform of Existing Structures*

The Priority Reform and Restructuring Program – PRR – application submission from the Ministry of Commerce listed a number of reform tasks, aimed at establishing a solid organizational structure. These were central recommendations and include:

- Disbanding the Department of Domestic Trade;
- Disbanding and re-allocating the Departments of Audit, Planning as well as Accounts and Balances;
- Reducing staffing levels in the Department of Foreign Trade;
- Reducing staffing levels and streamlining Department of Export Promotion functions;
- Broadening the Department of Business Licensing scope;
- Dividing the duties of the Department of International Transit;
- Reducing staffing in the Department of Administration;
- Re-allocating the duty of Financial Administration from the Department of Administration;
- Enhancing the capability of Administrative and Personnel Services;
- Forming a Private Sector Development Directorate;
- Forming a Legal and Regulatory Affairs Directorate;
- Enhancing oversight and initiating reform procedures in the Ministry's secondary institutions;
- Separating the Political and Civil Service structures within the MoC as well as
- Enhancing all coordination mediums.

A number of essential functions were kept within the Ministry of Commerce and are as follows:

- Legal and Regulatory Affairs,
- Consumer Protection and Standards,
- International Trade,
- International Transit and Trade Facilitation,
- Private Sector Development,
- Industrial Park System Development,
- Business and Investment Licensing as well as
- Secondary Institutional Reform.

Finally, the *implementation plan* for all of these restructuring items was set in place for the PRR Stage II application. At the conclusion of the project, it was scheduled for submission in 2006.

➤ *Donor and Ministerial Coordination*

As an element of the Trade Policy Reform Project, efforts were made to aid the Ministry of Commerce in coordinating the numerous donors and their tasks. This included the a) analysis of potential projects and programs as well as b) direct input or guidance for senior staff members.

Rather than establishing a brand new *consultative group*, the existing *Consultative Group for Trade and Investment* was used as the necessary forum, and BE played an active role within its scope. Finally, an inter-ministerial group for *World Trade Organization* accession was formed to foster coordination across the GOA on policy issues affecting Afghan accession into the WTO.

➤ *Elimination of Administrative Barriers to Trade*

A critical element in any Trade Policy Reform Project is the analysis of *administrative barriers to trade* and the subsequent proposal of a) remedial policies or b) catalytic bodies. Under the *Afghanistan Economic Governance Program*, a *Central Working Group* was established at the Ministry of Commerce to play an active role in the examination of trade barriers and formulation of strategies, to eliminate barriers altogether or reduce their effects.

Initially, working group members were selected based on qualifications and relevant experience. The newly formed group was then responsible for establishing its policy, procedures and overall strategic mission. In order to monitor progress and relay information to senior management, the working group held regular monthly meetings, where activities were documented and later disseminated to certain intra-ministerial departments. The group was and continues to be a key step in the reform process, since it a) provides consistency across policy analysis, b) keeps a knowledge base and c) maintains a legacy platform.

In conjunction with the *Central Working Group*, a number of specialized working groups were established in light of Afghanistan's commercial aptitudes. Seven discrete working groups were established in the final year of the project and include:

- The Karakul Institute,
- Handi-craft Joint Company,
- Raisin and Dry Fruit Export Promotion,
- Animal Products Guild,
- Exhibition Department,
- Medical Herbs Department and
- Carpet Producer's Guild.

➤ *Business Licensing Reform*

Business Licensing is a key function within the Ministry of Commerce; therefore, a major piece of the Trade Policy Reform Project was the a) analysis of existing policies, b) proposal of new procedures and c) implementation of streamlined reform. Prior to these steps, however, an examination of the existing *Licensing Department* was performed, leading to the proposal of numerous changes within the organizational structure, followed by their implementation.

Upon completion of this initial task, actual licensing regulations and procedures were examined in Kabul City. Based on the project's findings, process changes were proposed to senior personnel and subsequently implemented within the Ministry of Commerce itself. In order to ensure a consistent approach, standard operating procedures (SOPs) were designed, and this included a revised Business License Application form. At the same time, the project assessed the activities and functions of border, provincial *Licensing Departments*. Analysis was aimed at a) enhancing their functions and b) spreading any standards across Afghanistan. The regions included:

- Herat,
- Jalalabad,
- Mazar-e-Sharif,
- Kandahar and
- Konduz.

As a measure of general progress, the “before and after” highlights the streamlined reform measures that took place and are now functioning in Kabul City as well as numerous Afghan regions. *Before prerequisites* were:

- *Pre-approval* from the Minister or Deputy Minister of Commerce,
- A *deposit* of at least Afn 250,000 or the issuance of collateral,
- Two *recommendations* from local Business License holders,
- Forty-one *steps* in the Business License *application process*,
- Fifty-eight *signatures* required for the granting of a license and
- Eight or more weeks of *processing time*.

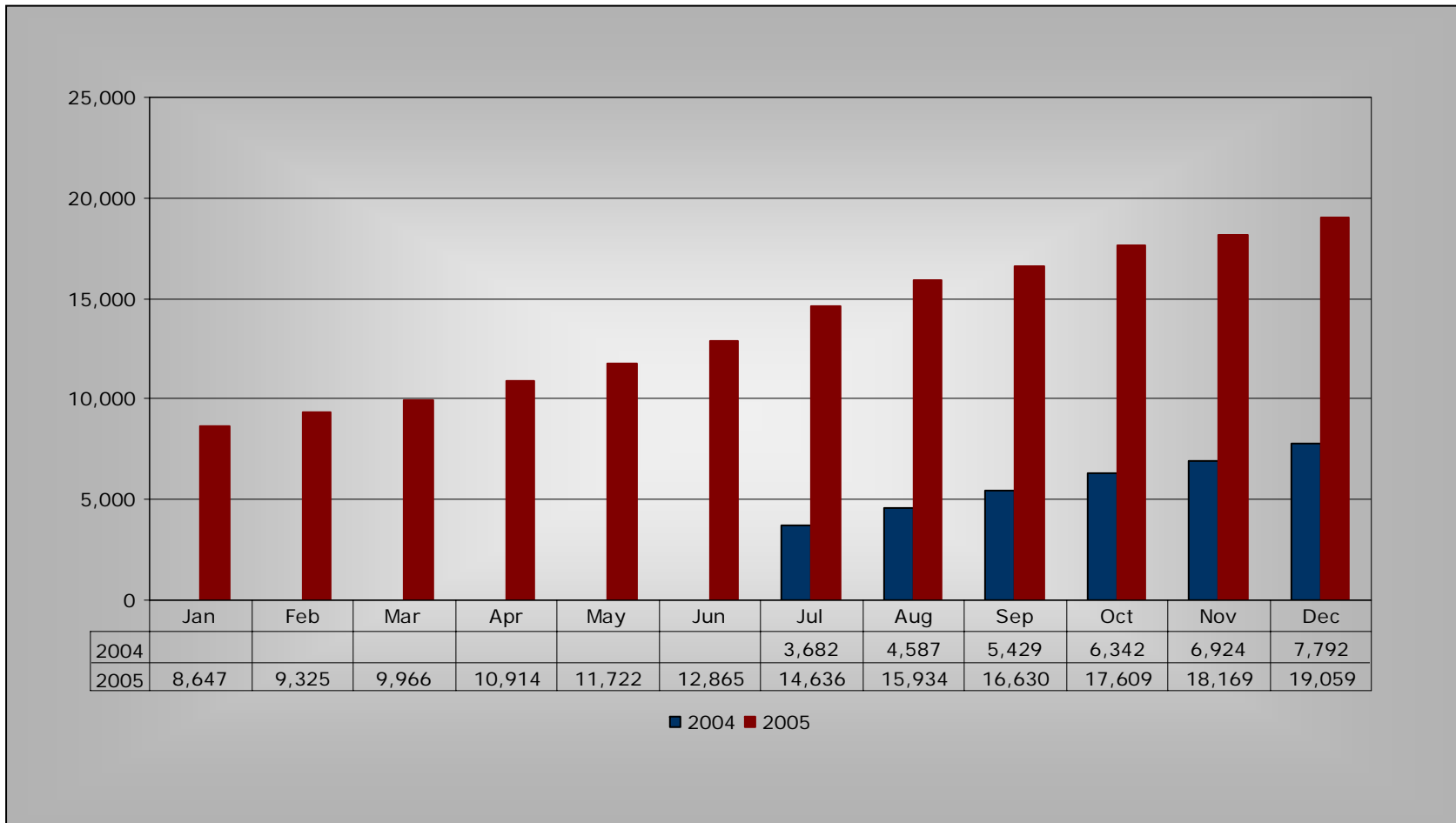
After prerequisites were reduced to:

- Forty-eight hours of processing time,
- 3 steps in the Business License application process and
- 6 signatures.

Finally, a number of tasks were aimed at sustaining these enhanced procedures. For instance, the project conducted numerous Business Licensing *seminars* for personnel from all regions, aimed at enhancing professional skills and fostering increased capacity. In addition, new Business Licensing processes were announced to the general public, through brochures and other media, in order to raise public awareness. Moreover, a *license database* was designed and installed in Kabul City. The system is a reliable means of a) storing historical licensing information and b) automating many of the processes.

* Please see the following page for a cumulative depiction of Business Licenses issued in the *second* and *third years* of the AEG Program.

➤ 2004 and 2005 – Business Licenses Issued – *Afghanistan*



➤ *Obstacles to Progress*

There are three central obstacles to progress at the Ministry of Commerce. First and foremost, progress at the Ministry was slow, due to existing staffing. While the Minister and Senior Staff possess clear principles regarding trade policy, the Department Heads have a minimal understanding of general market systems, coupled by a strong commitment towards protectionism. As the ministry undergoes restructuring, this issue must be diminished.

Second, across most GOA ministries, there is poor cooperation, and furthermore, there appears to be confusion as to the responsibilities of trade policy. Although the MoC has explicit duties with regard to trade policy, the Ministry of Finance and Ministry of Foreign Affairs also play a role. At the same time, the division of tasks between the Ministry of Foreign Affairs and Ministry of Commerce is unclear and has resulted in differing notifications to the WTO, along with a delay of three years in receiving observer status. In addition, this problem was exacerbated by slow progress prior to 2005, which led to other agencies encroaching on MoC tasks.

Finally, a lack of coordination between donors at the Ministry of Commerce, especially multiple and often differing visions of progress, led to substantial difficulties. The policy of the Government of Afghanistan is clearly based on markets, and the policy of the Minister and the Ministry is free, responsible trade. However, many donor agencies continue to advocate protectionist positions, which result in *conflicting advice*.

➤ *Guidance for Future Reform*

The Ministry of Commerce now has a broad strategy for policy. In going forward, trade policy reform should be guided by this policy, and the key challenge is building consensus at the more junior staff levels. Additionally, a continuation of effort to build coordination between the numerous GOA ministries, linked to trade policy, will be a foremost priority. At the same time, there continues to be far too much territory protection between ministries, with poor communication and minimal information sharing.

Lacking increased coordination, the Ministry of Commerce will find it challenging to implement its policies across the GOA. Finally, there is a growing tendency to rely on technical advisors, as well as the Senior Staff for the design of major documents and policy. As a result, it will be increasingly necessary for advisors to assume *background responsibilities* rather than *direct roles*.

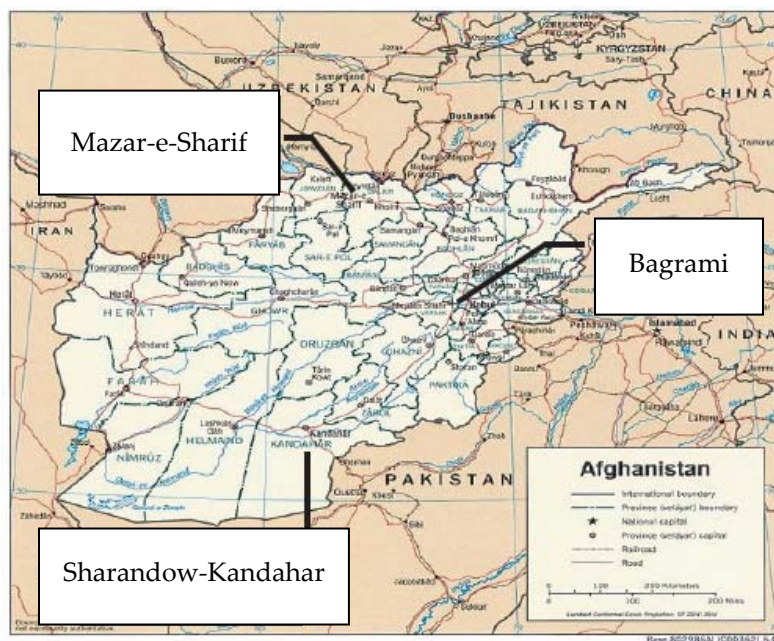
Industrial Parks

Industrial parks have traditionally been defined as “large tracts of land, subdivided and developed for the simultaneous use of numerous firms, further distinguished by its shared infrastructure.” In Afghanistan, this concept was adopted as a strategic tool for the stimulation of *domestic business growth* as well as *direct foreign investment*.

The aim in Afghanistan was to diversify the economic base, create long-term jobs and provide skill development opportunities for employees. Industrial parks are strong mediums for promoting infrastructure and manufacturing capabilities, elements that will foster economic development. In conjunction with this long-term approach, international best practices were employed to promote higher standards of construction, operability and maintenance.

Amendments to Afghanistan’s Investment Law provided further incentives for the *industrial park concept*. They included: a) depreciation of machinery (25% per year), b) loss carry forward and c) a two-year allowance for taking profits out of Afghanistan. Finally, the *Afghan Investment Support Agency (AISA)* will offer a wide array of business support services to investors.

➤ 3 Industrial Parks



➤ *Background*

Industrial parks are powerful catalysts for economic growth within transitional economies. The most obvious benefit of an industrial parks project is the supply of scarce industrial property (including serviced land, transportation access, utilities and pre-built facilities) to meet private sector demands for business establishment and expansion. At the same time, they produce important benefits for urban environments, including occupational health and safety for workers as well as land values, since both formal and informal industrial business activity often migrates from congested areas to industrial parks.

Industrial parks in transitional economies are often limited to physical development, which takes place within a broader framework of land use planning, economic regulation, and investment promotion. In the developing world, successful industrial park projects must address policy constraints and infrastructure bottlenecks to attract both domestic and foreign investors.

Industrial property development frameworks in Afghanistan are largely inadequate. They rely on public sector planning, development and the management of zoned industrial areas, responsibilities for which the public sector does not have significant influence. In addition, private developers continue the aggressive marketing of other industrial parks to replace existing tenants with higher-value investors. In light of this framework, the *Industrial Parks Project* was designed to a) manage risk, b) lower up-front capital costs, c) accelerate project start-ups and d) adapt facility size to market demand.



➤ *Project Lifecycle*

As illustrated on the introductory page, the *Industrial Parks Project* set out to build three distinct parks in three distinct locations. These included Kabul City, Mazar-e-Sharif as well as Kandahar. Each region was selected strategically and represents a different audience of investors. Together, the three sites offer wide coverage for industrial park usage across Afghanistan.

A high-level assessment was performed at the onset of the project, and a road map for reform was subsequently produced. The map included all the tasks needed to build the three industrial parks and is shown here:

| Task Name | Status |
|---|--------|
| Establish <i>legal and management structures</i> for managing IPs | ✓ |
| Draft <i>presidential decree</i> | ✓ |
| Identify <i>implementer</i> for physical development of IPs | ✓ |
| <i>Issue solicitation</i> | ✓ |
| <i>Evaluate vendors</i> | ✓ |
| <i>Select implementer</i> | ✓ |
| Identify 3 sites for IPs | ✓ |
| <i>Kabul City</i> | ✓ |
| <i>Mazar-e-Sharif</i> | ✓ |
| <i>Kandahar</i> | ✓ |

| Task Name | Status |
|---|--------|
| Facilitate <i>land transfer approval</i> | ✓ |
| Draft English version of <i>presidential decree</i> | ✓ |
| Translate English version into <i>Dari language</i> | ✓ |
| Submit decree to the <i>Ministers of Finance and Commerce</i> | ✓ |
| Develop <i>preliminary business plans</i> for the IPs | ✓ |
| <i>Kabul City</i> | ✓ |
| <i>Mazar-e-Sharif</i> | ✓ |
| <i>Kandahar</i> | ✓ |
| Develop a <i>consolidated preliminary business plan</i> | ✓ |
| Develop <i>Final Business Plan</i> | ✓ |
| Develop <i>site layouts</i> for all 3 IPs | ✓ |
| <i>Kabul City</i> | ✓ |
| <i>Mazar-e-Sharif</i> | ✓ |
| <i>Kandahar</i> | ✓ |

| Task Name | Status |
|---|--------|
| Develop <i>marketing materials</i> for all 3 IPs | ✓ |
| <i>Brochures</i> in both <i>English</i> and <i>Dari</i> (1,000) | ✓ |
| <i>Newspaper</i> as well as <i>magazine</i> ads | ✓ |
| Develop <i>Investor Guides</i> for IPs | ✓ |
| Identify <i>contents</i> | ✓ |
| <i>Afghan Map</i> | ✓ |
| Law on <i>Domestic and Foreign Private Investment</i> | ✓ |
| <i>Private Investment Project Analysis</i> form | ✓ |
| <i>Geographic, Economic and Political</i> information | ✓ |
| Legal <i>labor requirements</i> | ✓ |
| <i>Currency and exchange rate</i> information | ✓ |
| <i>Investment Regulations – capital and dividends</i> | ✓ |

| Task Name | Status |
|---|--------|
| Plot <i>layouts</i> as well as <i>infrastructure</i> | ✓ |
| Building <i>layouts</i> as well as <i>infrastructure</i> – Bagrami | ✓ |
| <i>Benefits, Exemptions</i> and <i>Obligations</i> | ✓ |
| <i>Site location</i> descriptions | ✓ |
| <i>Zoning Regulations</i> | ✓ |
| Offered <i>products</i> – plots for sale and building space for lease | ✓ |
| Offered <i>services</i> | ✓ |
| Lease and sale <i>application forms</i> | ✓ |
| <i>Leasing</i> and <i>sales agreements</i> | ✓ |
| <i>Development guidelines</i> | ✓ |
| <i>Prices</i> and <i>fees</i> | ✓ |
| <i>Environmental requirements</i> | ✓ |
| Selection process for <i>investors</i> or <i>tenants</i> | ✓ |

| Task Name | Status |
|--|--------|
| Design <i>infrastructure</i> of IPs | ✓ |
| Conduct <i>pre-engineering studies</i> | ✓ |
| Build <i>infrastructure</i> | ✓ |
| Sell <i>plots</i> or select <i>tenants</i> | ✓ |
| Organize <i>public tenders</i> | ✓ |
| Transact <i>final sales</i> | ✓ |

➤ *Bagrami Groundbreaking Ceremony*

On July 22, 2004 the *Bagrami Industrial Park* groundbreaking ceremony took place and included notable attendees, such as former US Ambassador Khalilzad, former Afghan Commerce Minister Kazemi and former USAID Mission Director Patrick Fine.



➤ *Bagrami Industrial Park*



| | |
|-----------------------------|---|
| <i>Location</i> | 7 km southeast of downtown Kabul and 12 km from Kabul Airport |
| <i>Features</i> | Reliable electric power supply |
| | 24 hour site security |
| | Paved roads – designed for heavy traffic |
| | Central water and sewage systems |
| <i>Development Schedule</i> | Site grading – June 2004 |
| | Infrastructure – August 2004 |
| <i>Target Industries</i> | Light manufacturing |
| | Plastic production |
| | Pharmaceuticals |
| | Textiles |
| | Food and beverage products |

On September 14, 2004 the *Afghanistan Industrial Parks Conference* was held at the Sadarat Gul Khana Palace. Bringing together a number of national investors, the seminar highlighted the scheduled land distribution methodology for the park.



Mr. Noorollah Delawari, former president of the *Afghan Investment Support Agency* (AISA), was in attendance and outlined Phase One of industrial park construction and explained the proximity of the *Bagrami Industrial Park* to Kabul City. This brings much needed electricity, water supply, communications and canalization capacities.

Finally, Mr. Obaidollah Ramin, president of Afghanistan's *International Chamber of Commerce*, described the Chamber's goal of establishing a competitive environment for private sector growth and international commerce, an economic construct based on free market principles. Industrial parks in Afghanistan will be critical instruments in the realization of these long-term goals.

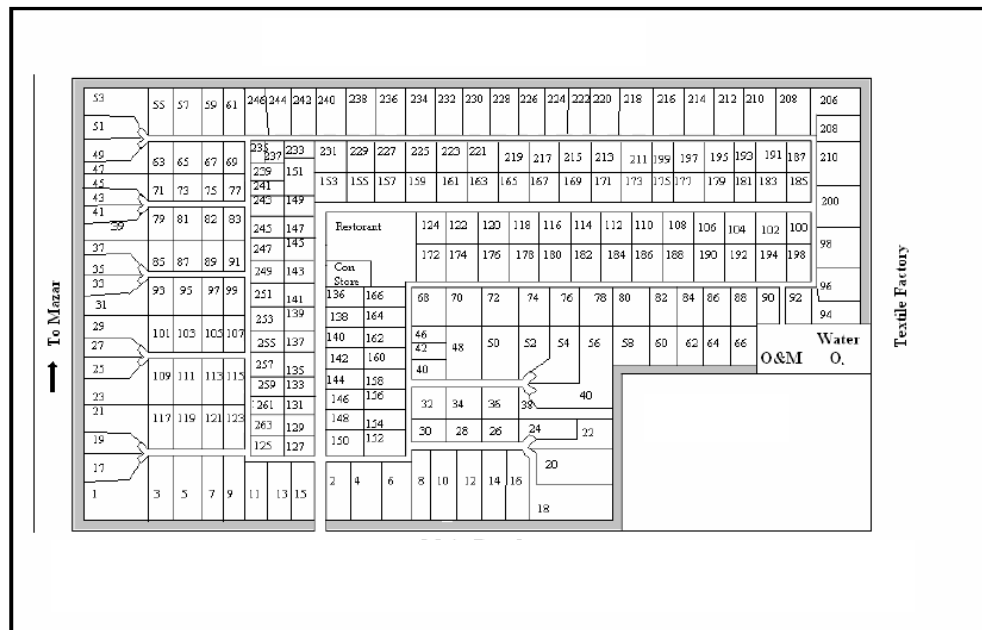


■ *Before and After Photographs*





➤ *Mazar-e-Sharif Industrial Park*



| | |
|-----------------------------|---|
| <i>Location</i> | Approximately 7 km south of downtown Mazar-e-Sharif and 12 miles from the local airport |
| <i>Features</i> | Site Area = 36 hectares |
| | 10 ha. Plot area for the Edible Oil Processing Plant |
| <i>Development Schedule</i> | Site survey – June 2004 |
| | Grading – July 2004 |
| | Infrastructure – September 2004 |
| <i>Target Industries</i> | Light manufacturing |
| | Plastic production |
| | Pharmaceuticals |
| | Textiles |
| | Food and beverage products |

| | | | | | | | | | |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|----|
| 109 | 107 | 105 | 103 | 101 | 99 | 97 | 95 | 93 | 91 |
| 111 | 149 | 151 | 153 | 155 | 157 | 159 | 161 | 163 | 93 |
| 113 | 133 | 135 | 137 | 139 | 141 | 143 | 145 | 147 | 95 |
| 115 | 117 | 119 | 121 | 123 | 125 | 127 | 129 | 131 | 97 |
| 71 | 73 | 75 | 77 | 79 | 81 | 83 | 85 | 87 | 89 |

Main Entrance

| | | | | | | | |
|----|----|----|----|----|----|----|-------------|
| 39 | 37 | 35 | 33 | 29 | 27 | 25 | Restaurant |
| 41 | 69 | 67 | 65 | 63 | 61 | 59 | Conv. Store |
| | 43 | 45 | 47 | 49 | 51 | 53 | 55 |
| 1 | 3 | 5 | 7 | 9 | 11 | 13 | 15 |
| | | | | | | | 17 |
| | | | | | | | Wash. T.P. |

| | | | | | | | |
|-----|-----|-----|-----|-----|-----|-----|----|
| 104 | 102 | 100 | 98 | 96 | 94 | 92 | 90 |
| 106 | 146 | 144 | 142 | 140 | 138 | 136 | 88 |
| 108 | 124 | 126 | 128 | 130 | 132 | 134 | 86 |
| 110 | 112 | 114 | 116 | 118 | 120 | 122 | 84 |
| 68 | 70 | 72 | 74 | 76 | 78 | 80 | 82 |

| | | | | | | | |
|-------|----|----|----|----|----|----|----|
| 36 | 34 | 32 | 30 | 28 | 26 | 24 | 22 |
| 40 | 64 | 62 | 60 | 58 | 56 | | 20 |
| 42 | 46 | 48 | 50 | 52 | 54 | | 18 |
| O&M 2 | 4 | 6 | 8 | 10 | 12 | 14 | 16 |

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➤ *Status and Transfer*

The *Industrial Parks Project* was initiated under the USAID *Afghanistan Economic Governance Program*. Being a large infrastructure project, with numerous tasks spread across more than one region, BearingPoint was assigned the coordination and management of all tasks until August 2005. At that point, Technologists Incorporated assumed complete responsibility for the remainder of the project, which is scheduled to end on May 30, 2006.

Having these timeframes in mind, the following is a *contract-end* summary for all of the industrial parks.

■ *Bagrami Industrial Park*

- Finished infrastructure design,
- Began infrastructure building,
- Phase I – marketing phase done,
- Phase II – began marketing phase,
- Finished sales task for phase I and
- All 34 plots sold – see following page for all investors.

■ *Mazar-e-Sharif Industrial Park*

- Finished infrastructure design,
- Began infrastructure building,
- Began marketing phase and
- Sales task – 138 investor applications submitted.

■ *Kandahar Industrial Park*

- Finished infrastructure design,
- Began infrastructure building,
- Began marketing phase and
- Sales task – 19 investor applications submitted.

Finally, more than 800 Afghan staff members were employed for the *Industrial Parks Project*. Approximately 10,000 Afghans will be employed, when all three sites become fully operational.

| No. | Name of Company | Product | Allocated Plot Size | Plot # |
|-----|------------------------------|---------------------------------|---------------------|--------|
| 1 | Omed Kabul Co. | Salt production | 1,000 | 31 |
| 2 | Hakim Modern Clothes Washing | Dry Cleaning | 1,000 | 23 |
| 3 | Mumtaz Ltd | Paper | 1,000 | 35 |
| 4 | Sadat Ltd | Doors & windows (Vitren) | 1,000 | 27 |
| 5 | Popaliar Ltd | Plastic bowls and bags | 1,000 | 29 |
| 6 | Mumtaz Ltd | Sausage | 1,000 | 37 |
| 7 | Alhaj Raqib Plastic Complex | One time usage articles | 1,000 | 30 |
| 8 | Abdul Wasai Ltd | Tailoring | 1,000 | 25 |
| 9 | Sadaf Ltd | Laundry Detergent | 1,000 | 33 |
| 10 | Haidari Ltd | Food product | 1,000 | 28 |
| 11 | Haseeb Zubir Ltd | Cartons and Shrapnel production | 1,000 | 26 |
| 12 | Shamshad Ltd | Plastic Pipe & Shoes | 1,000 | 24 |
| 13 | Faizan Massoud Filtering Co | Oil and Air Filters | 2,000 | 7 |
| 14 | Qane Ltd | One time usage articles | 2,000 | 8 |
| 15 | Tarsian-Blinkley Ltd | Tailoring | 2,000 | 9 |
| 16 | Fakhre Afghan Ltd | Plastic (PVS) windows & doors | 2,000 | 10 |
| 17 | Shekaib Firm | Soap and Shampoo | 2,000 | 12 |

| No. | Name of Company | Product | Allocated Plot Size | Plot # |
|-----|----------------------|-------------------------------------|---------------------|--------|
| 18 | Ayenda Durukhshan | Salt production | 2,000 | 13 |
| 19 | Hasheme Ltd | Printing press | 2,000 | 14 |
| 20 | Khiber Naseri Ltd | Metal products and aluminum dishes | 2,000 | 11 |
| 21 | Shaheen Factory | Candy | 2,000 | 15 |
| 22 | Bahodur Obaid Ltd | Chocolate, chewing gum and candy | 2,000 | 16 |
| 23 | Saneh Ltd | Pressure cooker | 2,000 | 17 |
| 24 | Qasemi Ltd | Meat, egg and dairy | 2,000 | 18 |
| 25 | Azin Food Industry | Macaroni, cookies, chocolate, candy | 2,000 | 22 |
| 26 | Salang Ltd | Bottled water | 2,000 | 20 |
| 27 | Khalil Zada Ltd | Diary Products | 2,000 | 2A |
| 28 | Azimudin Najib Ltd | Plastic Pipe | 2,000 | 21 |
| 29 | Habib Gulzar Ltd | Ice cream and warehouse | 4,000 | 4 |
| 30 | Ahmad Printing Press | Books, magazines, journals, etc. | 4,000 | 1 |
| 31 | Emran Rezwan Ltd | Juice, Coca Cola and water | 4,000 | 2 |
| 32 | Khalil Najib Ltd | Furniture (wood and metal) | 4,000 | 6 |
| 33 | Delpazer Ltd | Bread and cake | 4,000 | 3 |
| 34 | Jahan Win House | Furniture | 4,000 | 5 |

Program Contractual Compliance

The following section includes a detailed summary of all “contractual responsibilities,” under the USAID *Afghanistan Economic Governance Program*. In addition, it includes the “completion status” of each responsibility, which is defined using one of the following three categories:

- *Completed,*
- *Partially Completed or*
- *Not Completed.*

Finally, each of the aforementioned “contractual responsibilities” was identified directly from “Section C – Descriptions / Specifications / Revised Statement of Work,” as defined under “Attachment 1, 306-C-00-03-000091, Modification 009” of the USAID *Afghanistan Economic Governance Program*. Furthermore, “sector codes” have also been provided, linking the various “contractual responsibilities” to their particular *technical assistance* area. Here is a list of the various “sector codes” and their corresponding *technical assistance* area:

- FIS = *Fiscal,*
- FIN = *Financial,*
- TR = *Trade Policy,*
- LR = *Legal and Regulatory and*
- P = *Privatization.*

| <i>Sector Code</i> | <i>Contractual Responsibility</i> | <i>Completion Status</i> |
|--------------------------------|--|--------------------------|
| <i>Fiscal Technical Sector</i> | | |
| FIS 1 | Support for the development and institutionalization of the revenue data gathering and analysis activities of the Ministry of Finance. | Partially Completed |
| FIS 2 | Support for the development and presentation of a fiscal policy outlook paper to form the basis for preparation of the annual budget. | Completed |
| FIS 3 | Support of development and budgetary capacity of the Mustofiats (provincial fiscal administration offices). | Partially Completed |
| FIS 4 | Establish and implement training programs for economic analysis within the Ministry of Finance and the regional Mustofiats. | Partially Completed |
| FIS 5 | Development of financial revenue forecasting and reporting methods. | Partially Completed |
| FIS 6 | Establishment of data on the tax system as it currently exists and has been administered recently, as it functioned during the 1978 - 1990 period, and as it functioned prior to the 1978 invasion by the Soviet Union to the extent possible to serve as a baseline. Estimation of the principal sources of tax revenue. | Partially Completed |

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| FIS 7 | Identify priorities for tax reform that respond to short-term and medium-term fiscal problems. | Completed |
| FIS 8 | Assist in the preparation of a revised income tax and design a strategy for its implementation. | Completed |
| FIS 9 | Assist with the preparation of a consumption tax and design its regulations as well as implementation strategy. | Partially Completed |
| FIS 10 | Design and introduce excise taxes on selected products. | Not Completed |
| FIS 11 | Assess need for property tax at provincial and local levels and make recommendations. | Completed |
| FIS 12 | Assess need of VAT for Afghanistan and make recommendations for design and implementation, if appropriate. | Completed |
| FIS 13 | Design of a new customs tariff and exemptions regime. | Completed |
| FIS 14 | Drafting of a Customs Code. | Completed |

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| FIS 15 | Establish and implement training programs in tax and customs reform policies. | Completed |
| FIS 16 | Establish a large taxpayer unit (LTU) in Kabul and later on in the provinces. | Completed |
| FIS 17 | Design and assist in the implementation of a Tax Identification Number (TIN). | Completed |
| FIS 18 | Review and assess the organizational structure of the tax administration from a regional and a functional perspective (collections, audits, arrears, processing, etc.) and make recommendations for efficient operation. | Completed |
| FIS 19 | Develop and institutionalize modern techniques of tax administration. | Completed |
| FIS 20 | Design organizational incentives to improve collections, such as a large taxpayer unit or medium-sized business unit. | Completed |
| FIS 21 | Design pilot programs to modernize tax system and introduce new operating concepts such as the taxpayer identification number. | Completed |
| FIS 22 | Support the design, implementation and institutionalization of core operating procedures in key tax administration functional areas (including registration, audit, collections, returns processing and taxpayer education) for the major taxes. | Completed |

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| FIS 23 | Support the design and implementation of a computerized audit selection methodology based on risk analysis for each of the major sources of tax revenue. | Partially Completed |
| FIS 24 | Support the design and implementation of an automated tax information computerization system at the provincial and municipal or district levels, covering relevant taxes. | Partially Completed |
| FIS 25 | Support the development and implementation of a database from samples of tax returns and management information reports related to major sources of tax revenue. | Partially Completed |
| FIS 26 | Support the design, compilation and distribution of monthly reports that contain performance indicators other than tax revenue for all major sources of tax revenue. | Completed |
| FIS 27 | Support the implementation and institutionalization of an overall training (and employee development) strategy as well as a training development and delivery program. | Completed |
| FIS 28 | Support the full implementation and institutionalization of a policy for exchanging tax data and other financial information with outside countries. | Partially Completed |
| FIS 29 | Support comprehensive public information and consultative program designed to disseminate information on the new tax policy and administration system to Afghan public officials, business groups and the wider public. | Completed |
| FIS 30 | Support the implementation of a new tariff and exemptions regime. | Completed |

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| FIS 31 | Support the implementation of a Customs Code including developing and implementing key administrative system and documentary reforms in Kabul and at least five regional provincial centers and selected border points. | Completed |
| FIS 32 | Support implementation of a new income tax code and taxation administration system through the creation of the large taxpayer unit, first to taxpayers in Kabul and then to other major cities. | Completed |
| FIS 33 | Build capacity within the Ministry of Finance to modernize and improve the efficiency of revenue collection. | Completed |
| FIS 34 | Adopt reforms that modernize structures and work practices and support recruitment of staff. | Completed |
| FIS 35 | Establish and implement training programs in tax and customs reform initiatives, including large taxpayer unit and customs house personnel. | Completed |
| FIS 36 | Educate the community on a new taxation and customs system. | Completed |
| FIS 37 | Introduce customs procedures and training to selected provincial and border customs posts. | Completed |
| FIS 38 | Provide some equipment to selected provincial and border customs posts to allow for the implementation of customs reforms. | Completed |

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| FIS 39 | Support the full and comprehensive implementation of an IMF-consistent budget that provides budgetary information by organizational structure, functional classification, economic classification and source of financing (at the line agency and provincial levels). | Completed |
| FIS 40 | Support the development of an integrated annual budget that covers the general government sector, provinces, municipalities or districts and the public enterprise sector. | Completed |
| FIS 41 | Support the full institutionalization of sound budget planning and reporting procedures in a manner which effectively incorporates program impact and cost-efficiency analysis into the budget review and determination process. | Completed |
| FIS 42 | Support the full integration of the capital and recurrent budgeting processes through the operation of the MOF budget planning unit and the institutionalization of a unified annual budget planning process for recurrent and capital expenditures. | Completed |
| FIS 43 | Support the design and institutionalization of the rolling planning process for the public infrastructure program. | Partially Completed |
| FIS 44 | Development and implementation of a fully automated budget planning, reporting and tracking system. | Completed |

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| FIS 45 | Support the development and implementation of specialized training programs covering all aspects of the budget planning and execution processes which will be provided to the Ministry of Finance as well as the line agencies. | Completed |
| FIS 46 | Support implementation of specialized training programs that will be conducted for relevant administrative staff of provincial government institutions and relevant administrative staff of the future Cabinet of Ministers and Legislative Assembly, to promote Afghan input into and build capacity to develop and monitor capital as well as recurrent budget planning activities. | Partially Completed |
| FIS 47 | Implement restructuring of the Budget Department and develop the capacity of Ministry of Finance staff to implement sound budget planning and reporting procedures, including program impact and cost-efficiency analysis, budget review and formulation processes as well as program and project analysis. | Completed |
| FIS 48 | Assist and support financial management capacities in the National Solidarity Program. | Completed |
| FIS 49 | Assist with human resource issues and process mapping of the offices of the Finance Minister, the Chief of Staff and the Deputy Ministers (to streamline operations). | Partially Completed |
| FIS 50 | Comprehensive assessment of how a finance system that appropriately defines the financial relationship between the central government and provinces would work in Afghanistan. | Partially Completed |

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| FIS 51 | Develop approach to collect fiscal information needed to analyze and utilize fiscal information at provincial and local levels of government. | Partially Completed |
| FIS 52 | Provide technical advice to the Treasury Department, within the Ministry of Finance, on fiscal reform issues. | Completed |
| FIS 53 | Provide technical assistance to and develop a master plan for the Valuable Documents Office, which is a department within the Treasury Section of the Ministry of Finance. | Partially Completed |
| FIS 54 | Enable and institutionalize change in the key areas of reform by providing timely and appropriate information technology as well as computerization expertise in Kabul and the regions. | Completed |
| FIS 55 | Enable and institutionalize change in the key areas of reform by providing an effective administrative services department within the Ministry of Finance. | Partially Completed |
| FIS 56 | Support the strategic planning and restructuring of major functions with the Ministry of Finance. | Partially Completed |
| FIS 57 | Support and make recommendations for the implementation of Individual Salary Payment procedures or policies for government employees (paid by the Ministry of Finance). | Completed |

| <i>Financial Technical Sector</i> | | |
|-----------------------------------|---|---------------------|
| FIN 1 | Support a macro-economic unit to collect and analyze statistics critical to the development of a macro-economic program. | Completed |
| FIN 2 | Support capacity to estimate money demand and prices, as part of the economic program. | Completed |
| FIN 3 | Support the development and presentation of macro-economic analysis and implications of money supply for economic growth. | Completed |
| FIN 4 | Support the development and presentation of macro-economic analysis as well as the impact of banking system and credit needs on economic growth. | Completed |
| FIN 5 | Support the development and presentation of macroeconomic analysis as well as the impact of exchange rate management on real sector growth, export potential and economic growth. | Completed |
| FIN 6 | Support development and presentation of financial programming as well as development of the economic program. | Partially Completed |
| FIN 7 | Establish and implement training programs in data collection and analysis as well as preparation of annual bank balance sheets. | Completed |

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| FIN 8 | Assess the regional and functional structure of the Central Bank and make recommendations to rationalize its operations. | Completed |
| FIN 9 | Assist the Central Bank in establishing a domestic payment system. | Completed |
| FIN 10 | Assist the Central Bank with establishing regional and international operations, through standard banking telecommunications networks. | Completed |
| FIN 11 | Support development and institutionalization of efficient operating procedures within the payments system division of the Central Bank. | Completed |
| FIN 12 | Support modernization of the market operations and payments system functions. | Completed |
| FIN 13 | Develop information technology support systems and provide technical services, to streamline bank operations and payment systems. | Completed |
| FIN 14 | Establish and implement training programs in market operations and payments. | Completed |
| FIN 15 | Facilitate financial viability assessments for the 3 commercial banks and 3 sector banks to determine their future capacity for becoming commercial banks, providing payment services and facilitating financial intermediation. | Completed |

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| FIN 16 | Help develop criteria for bank privatization, bank liquidation as well as resolution and bank restructuring. | Completed |
| FIN 17 | Help set up procedures to eliminate non-performing loans from banks' books and help design market approaches for addressing bad loan portfolios in the banking system. | Completed |
| FIN 18 | Help develop criteria for new entry into the commercial banking system in Afghanistan. | Completed |
| FIN 19 | Provide strategic advice on the provision and appropriate regulation of supplementary financial operations, which ensure adequate availability of basic banking services in Afghanistan if these cannot be adequately provided by the licensed commercial banks in the banking system. | Partially Completed |
| FIN 20 | Design Central Bank "problem bank resolution process" and assist the CB to implement policies and guidelines for working with the management of troubled banks. | Completed |
| FIN 21 | Advisors will assist the CB in developing bank privatization techniques to minimize the impact of problem banks on the system (e.g. merger; change of ownership; new capitalization; resolution of problem assets as well as liquidation). | Completed |
| FIN 22 | The advisors will work with the staff, management and expatriate advisors, as directed by the Governor of the CB and with the approval of USAID. | Completed |
| FIN 23 | Assist and incorporate a heal system into the formal banking system, as appropriate. | Partially Completed |

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| FIN 24 | Assist the CB in the general development of the banking and financial services sector, including NBFI's to develop savings and lending markets as well as micro & rural finance throughout Afghanistan. | Partially Completed |
| FIN 25 | Provide an assessment of bank supervision in Afghanistan, using the 25 Basle Core Principles of Bank Supervision as the base for analysis. | Completed |
| FIN 26 | Assess institutional capacity for supervision and furnish timely recommendations, with action plans and timetables. | Completed |
| FIN 27 | Assist in implementing institutional changes, as agreed upon by the GOA and USAID. | Completed |
| FIN 28 | Assess training needs, provide recommendations and design an action plan with a timetable for implementation. | Completed |
| FIN 29 | Assist in the formulation and implementation of an overall mission statement and strategic plan for bank supervision. | Completed |
| FIN 30 | Develop a public relations strategy to inform the public on reform progress. | Completed |
| FIN 31 | Establish and implement a modern financial and accounting system, in accordance with international standards. | Partially Completed |
| FIN 32 | Support human resource development, practical training experience and capacity building of bank staff. | Completed |

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| FIN 33 | Assist in conducting on-site inspections of local banks. | Completed |
| FIN 34 | Make recommendations and help draft, where necessary, legislation and regulations to provide a better framework for bank supervision and to provide CB staff with the appropriate legal and punitive authority to carry out their supervisory mandate. | Completed |
| FIN 35 | Assist in the public outreach aspect of supervision by helping to design appropriate materials to introduce new regulations and policies to the financial and accounting community. | Completed |
| FIN 36 | Provide support to prepare bank licensing legislation. | Completed |
| FIN 37 | Assist the CB in developing and implementing new procedures and criteria to analyze applications for new bank licenses and banking activities. | Completed |
| FIN 38 | Provide support for review and implementation of a sound accounting system in the Headquarters Office and integrated into the newly formed branch offices; and for the institutionalization of sound accounting procedures and practices at Headquarters Office and all branch offices. | Partially completed |
| FIN 39 | Assist staff in improving the range of tools, consistent with current banking law and supervisory authority, which can be used to enforce corrective actions for banks and to resolve weaknesses identified during onsite inspection and offsite analyses. | Completed |

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| FIN 40 | Assist the CB in developing and implementing an effective and timely regulatory reporting process. | Completed |
| FIN 41 | Provide an assessment of the effectiveness and capabilities of back office operations and ensure their appropriateness and ability to support the CB mission. | Completed |
| FIN 42 | The advisors will assist the CB in developing instruction manuals and/or training seminars to ensure that bankers as well as CB staff understand the financial reporting requirements as well as their purpose. | Completed |
| FIN 43 | Assist the CB in starting the elaboration of an internal bank rating system to provide an analytical basis for making supervisory decisions. | Completed |
| FIN 44 | Assist the CB in starting the development of an early warning process, setting forth criteria which would serve as the basis for identifying troubled banks. | Completed |
| FIN 45 | The Bank Supervision Department evolves its processes so that risk-based supervision becomes the basis for both its inspection and enforcement functions. | Completed |
| FIN 46 | Develop and implement on-site inspection processes, based on prudential bank regulations which would result in a CAMELS (capital, assets, management, earnings and liquidity, sensitivity to market risk) type rating process. | Completed |

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| FIN 47 | Develop on-site examination procedures with a focus on understanding risks, inherent in banking and banking activities. | Completed |
| FIN 48 | Assist the CB in developing a basic on-site inspection manual based on international standards of banking supervision. | Completed |
| FIN 49 | Assist CB staff in finalizing the format for the "Report of Inspection," used to communicate inspection findings to both bank management and CB management. | Completed |
| FIN 50 | Assist the CB in developing enforcement procedures for violations of prudential standards or CB relevant laws, disclosed by the on-site inspection. | Completed |
| FIN 51 | Provide training to CB senior management, enabling them to effectively evaluate staffing needs, develop job descriptions as well as assess and reward staff as appropriate. | Completed |
| FIN 52 | Assist with the full adoption and effective implementation of sound (IAS-consistent) accounting standards (provided by the CB) in all licensed financial institutions. | Partially Completed |
| FIN 53 | Assist the CB in developing a training program and training materials for on-site inspection and off-site analysis as well as a core group of examiners, trained in all aspects of these disciplines. | Completed |

| <i>Trade Policy Technical Sector</i> | | |
|--------------------------------------|--|---------------------|
| TR 1 | Exchange Rate and Tariff Rates Optimization - Provide analysis to policy makers on the importance of coordinating exchange rate changes and tariff policy and work with the tax policy assistance and the monetary unit to develop appropriate tariff structure. | Partially Completed |
| TR 2 | Assist in the development and approval of core commercial laws, including those governing, trade laws (consistent with WTO standards), sanitary and phyto-sanitary measures as well as customs laws. | Partially Completed |
| TR 3 | Specialized and Tailored Laws: Assist with the drafting of specialized laws that target Afghanistan's unique opportunities and characteristics. | Completed |
| TR 4 | Export Opportunities: Conduct a study on Afghanistan's economic situation and opportunities to initiate business activity in selected areas for which Afghanistan has the appropriate climate, location, skills and capital. | Completed |
| TR 5 | Review standards and certifications to set up a system whereby standards for trade are consistent with international standards, to ensure access to export markets. | Completed |

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| TR 6 | Establish a women's entrepreneurship working group as well as a comprehensive business development services training and workshop program. | Completed |
| TR 7 | Assist in establishing the Office of the Minister within the Ministry of Commerce by introducing modern office operation procedures and management information systems, while training staff in their use. | Completed |
| TR 8 | Build the capacity of and assist the government and private sector to organize and conduct trade and investment conferences, promoting Afghanistan's competitiveness. | Completed |
| TR 9 | Assess and prepare a detailed business plan for the development of industrial parks in Afghanistan. | Completed |
| <i>Legal and Regulatory Technical Sector</i> | | |
| LR 1 | Assess the body of commercial law and develop an overall strategy to proceed with property law reforms. | Completed |
| LR 2 | Prepare a plan and implement the reorganization of property deeds in the Kabul Province, as a pilot project suitable for duplication in other provinces. | Completed |

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| LR 3 | Assist the Judicial Commission in all areas of real property law reform. | Completed |
| LR 4 | Assess legal and regulatory barriers to investment and propose alternatives to eliminate them. | Partially Completed |
| LR 5 | Review the new Investment Law and propose approaches to ensure it is successfully implemented or revised. | Completed |
| LR 6 | Liaise with other donors and refine the initial draft Banking Law generated by the IMF, including the translation of an adequate Dari version of the draft. | Completed |
| LR 7 | Assist and track implementation of the banking law through the legislative process. | Completed |
| LR 8 | Determine the existing legal regime and make a quick determination of where the largest gaps are in terms of laying the foundation for a market-oriented commercial law system. | Completed |
| LR 9 | Assist with the development and enactment of draft laws within the core commercial laws, including those governing property, contracts, company registration and corporate governance. | Partially Completed |

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| LR 10 | Assist other sectors of the commercial legal community, creating a more sustainable commercial legal regime. | Partially Completed |
| LR 11 | Development and implementation of sustainable training programs in core commercial law areas will include full development of commercial law training programs at higher schools of Law and Business as well as a training program for commercial law judges. | Not Completed |
| LR 12 | Establish a public information and consultative program designed to disseminate information on the new commercial law framework to both legal professionals and the wider public. | Partially Completed |
| LR 13 | Review, analyze and draft provisions and make recommendations concerning intellectual property rights as well as the goods and services sectors, such as insurance and transport or competition and regulatory policy. | Partially Completed |
| LR 14 | Review, analyze and draft provisions and make recommendations concerning the Bankruptcy Law and its procedures. | Not Completed |
| LR 15 | Develop and propose recommendations for a Collateral Law. | Not Completed |
| LR 16 | Review, comment and propose recommendations on the commercial code provisions on company law, including working with business people to determine what areas, if any, of the current Commercial Code provisions are considered useful. | Completed |

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| LR 17 | Review Commercial Procedure Law and recommend appropriate revisions. | Partially Completed |
| LR 18 | Liaise and cooperate with commercial court judges, who are responsible for implementing commercial law reform - for instance, the Commercial Court of Kabul. | Partially Completed |
| LR 19 | Assess ways to improve the reporting of commercial court cases, in order to promote consistency in deciding similar cases. | Partially Completed |
| LR 20 | Review commercial legal practices and court procedures, including the assessment of fees and fee structures for court documents. | Partially Completed |
| LR 21 | Develop and establish training programs for Afghan public officials and legal experts. | Partially Completed |
| LR 22 | Assist in the implementation of privatization laws, such as the comprehensive Telecom Law, providing a corporatization model for public utilities and state owned enterprises. | Completed |
| LR 23 | Assessment of the status of public utility companies – Ministry of Water and Power, Ministry of Communications – and how to reorganize the sector, such that policy and regulation is separated from operational aspects of the companies. | Completed |

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| LR 24 | Identify operational companies to be privatized and split off of the public sector. | Completed |
| LR 25 | Assist with full adoption of a comprehensive regulatory framework for the operation of an umbrella, independent regulatory oversight authority. | Partially Completed |
| LR 26 | Support for the design and effective operation of an umbrella public utility regulatory oversight body, which would incubate independent regulators within the public utilities sectors. | Partially Completed |
| LR 27 | Support for the full development and implementation of competition policy-related guidelines and instructions, in the areas of market structure and licensing. | Completed |
| LR 28 | Provide the necessary fuel, consumables as well as related services and critical spare parts to the Northwest Kabul Plant during peak winter demand in both 2003 as well as 2004. | Completed |
| LR 29 | Develop an appropriate legal and regulatory framework – allowing the promotion of private sector investment in the public utilities sector: Ministry of Water and Power as well as the Ministry of Communications. | Partially Completed |

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| LR 30 | Develop the institutional structure and processes of key departments within the Ministry of Water and Power, Ministry of Mines and Industry as well as the Ministry of Communications. | Partially Completed |
| LR 31 | Build capacity and improve professional expertise in the power, oil and gas sectors. | Partially Completed |
| LR 32 | Promote private sector participation in the exploration and production of oil as well as gas. | Not Completed |
| LR 33 | Provide extensive training and education to key people and build human resource capacity within the Ministry of Water and Power, the Ministry of Mines and Industry as well as the Ministry of Communications, in order to introduce the management and operational practices of world-class utilities. | Partially Completed |
| LR 34 | Assist in establishing regulatory agencies and frameworks within the Ministry of Water and Power and Ministry of Communications, in addition to training ministry staff on regulation processes. | Partially Completed |
| LR 35 | Develop specifications for a pilot billing and collection system for the Ministry of Water and Power, designed to bill and collect from large customers, as defined by the Ministry of Water and Power. | Completed |
| LR 36 | Installation of a Local Area Network (LAN) at selected public utilities and training for potential users of the system. | Completed |

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| LR 37 | Assist with the Telecom Law, which must be implemented by the new independent regulator, and assist with the potential disposal of the monopoly mobile service provider – namely AWCC – if so directed by the Ministry of Communications. Finally, aid with the restructuring of the fixed services provider, Afghan Telecom. | Completed |
| <i>Privatization Component</i> | | |
| P1 | Initial inventory and assessment of SOEs. (Assessment of banks will be completed separately in the TAA). | Not Completed |
| P2 | Aid in the strategy development of a comprehensive, time-phased and multi-tiered privatization program for SOEs. | Not Completed |

